

# Smart Metering Systems plc

## Final results for the year ended 31 December 2019

Smart Metering Systems plc (AIM: SMS, “the Group”), which installs and manages smart meters and carbon reduction assets (“CaRe”) to facilitate effective energy management, has published its final results for the 12 months to 31 December 2019.

The Group has also signed a partnership agreement with the Columbia Threadneedle Sustainable Infrastructure Fund (“ESIF”) to develop SMS’s pipeline of CaRe asset opportunities – see separate announcement.

On 12 March 2020, SMS announced that it has conditionally sold a minority of its meter assets to funds managed by Equitix Investment Management for a total gross cash consideration of £291 million. The disposal will enable the implementation of an enhanced long-term, sustainable dividend payment policy and results in a significant reshaping of SMS’s capital structure.

### 2019 financial performance

£’000	2019	2018
Group revenue	114,281	98,492
Index-linked annualised recurring revenue (ILARR) <sup>1</sup>	90,118	75,358
Pre-exceptional EBITDA <sup>2</sup>	58,897	51,619
EBITDA	50,370	35,478
Profit before taxation	5,463	5,351
Underlying profit before taxation <sup>3</sup>	15,577	25,085
Underlying basic EPS (p) <sup>4</sup>	11.30	18.46
Basic EPS (p)	3.56	3.97
Dividend per share (p)	6.88	5.98
Net debt	219,168	141,989

<sup>1</sup> ILARR is the revenue generated from meter rental and data contracts at a point in time. Includes revenue from third-party managed meters.

<sup>2</sup> Pre-exceptional EBITDA is statutory EBITDA excluding exceptional items.

<sup>3</sup> Underlying profit before taxation is profit before taxation excluding exceptional items and amortisation of intangibles.

<sup>4</sup> Underlying basic EPS is underlying profit after taxation divided by the weighted average number of ordinary shares for the purpose of basic EPS.

A reconciliation between reported and underlying performance is detailed in the Financial Review section below.

### Highlights

- **Financial**
  - Total ILARR increased 20% to £90.1m (2018: £75.3m)
  - Pre-exceptional EBITDA up 14% to £58.9m (2018: £51.6m)
- **Disposal** – announced 12 March 2020
  - £291m gross proceeds from asset disposal
  - Cash consideration will result in positive net cash position for Group overall
  - Post the disposal, retained Group ILARR is £73.2m as at 29 February 2020
- **Partnership with ESIF**
  - Funds SMS’s pipeline of Carbon Reduction (CaRe) assets
  - CaRe assets developed within SMS’s well-established energy management division
  - ESIF to fund and own the CaRe assets - SMS receives incremental long-term asset management fees
- **Business positioning and opportunities**
  - Smart meters
    - Growth in metering assets – total market c.36.5m meters to be exchanged
    - Existing SMS c.2m smart meter order book expected to add c.£40m ILARR
    - Existing SMS customers have additional c.4m to be exchanged

- Dividend
  - Long-term sustainable growing dividends with upside potential from existing and new meter assets
  - Proposed FY20 dividends increased to 25p – grow at least in line with RPI p.a. to 2024
- Sustainability is at the heart of SMS' operations
  - Smart meters are integral part of a flexible, decentralised and decarbonised energy system
  - Well placed to originate CaRe assets in current and emerging electricity generation, storage, heat, lighting and transportation industry market segments

**Alan Foy**, Chief Executive Officer, commented:

***“A 20% increase in our key financial metric - ILARR - and a 14% increase in EBITDA in extremely challenging markets, is a testimony to our market position and operational capabilities.***

***“Last week’s transaction will not only realise considerable cash returns and demonstrates the substantial value of our smart meter portfolio but also will enable us to enhance greatly shareholder value with a significant and sustainable increase in dividends.***

***“The UK is the first major economy to adopt net zero emissions by 2050, mainly by electrification strategies. This will need the establishment of a decentralised and decarbonised energy system as well as substantial capital to meet that target.***

***“A combination of our strengthened balance sheet to support our smart meter rollout programme, today’s partnership announcement with ESIF and our energy management division’s track record, positions us extremely well to accelerate and rapid expand our CaRe assets in the current and emerging electricity generation, storage, lighting, heating and transportation markets.”***

There will be an analyst conference call at 9.00am today - please contact [sms@instinctif.com](mailto:sms@instinctif.com) or telephone 020 7457 2077 for details. The full year results presentation will be published on the Group's website shortly.

#### **For further information:**

##### **Smart Metering Systems plc**

0141 249 3850

Alan Foy, Chief Executive Officer  
David Thompson, Chief Financial Officer  
Tim Mortlock, Chief Operating Officer  
Dilip Kejriwal, Head of Investor Relations

##### **Cenkos Securities plc (Nomad and Joint Broker)**

0131 220 6939 / 020 7397 8900

Neil McDonald / Pete Lynch

##### **Investec Bank plc (Joint Broker)**

020 7597 5970

Christopher Baird / Henry Reast

##### **Instinctif Partners**

020 7457 2077

Adrian Duffield / Kay Larsen / Chantal Woolcock

#### **Notes to editors**

SMS plc ([www.sms-plc.com](http://www.sms-plc.com)) installs and manages smart meters and carbon reduction assets (“CaRe”) to facilitate effective energy management. Established in 1995, SMS provides a full end-to-end service for metering financing, installation, management and maintenance, with a highly skilled workforce and deep engineering expertise.

SMS had 3.73 million meter and data assets under management as of 31 December 2019. SMS's smart meter expertise also enables the Company to provide consultancy services that allow organisations and corporates to enhance long term efficiency and effectiveness in the management of energy.

SMS's energy management and asset installation services also include infrastructure design, installation, consultancy and project management services for new gas, electricity, water and telecoms connections for licensed energy and telecoms suppliers, end consumers and the UK's licensed electricity Distribution Network Owners (DNOs).

SMS employs in excess of 1,200 people across the UK who support the installation and ongoing management of metering assets.

SMS plc is headquartered in Glasgow with 12 locations across the UK.

SMS's shares are listed on AIM.

## **Chairman's statement**

### **Introduction**

I am pleased to report that we ended the year in line with our expectations, and delivered continued growth in our ILARR, despite various industry-wide challenges. The continued volatility in the UK smart meter rollout has seen industry installation run rates lag behind previously anticipated volumes, and technical issues, beyond our control, have meant delays to certain customers getting "SMETS2 ready". As a result, we have had to navigate the knock-on effect of this on our operational activity and financial results.

Despite these challenges, and the resulting impact on our short-term profitability, it is important that we keep sight of the long-term opportunities our business can address. The smart meter rollout remains core to a lower carbon future for the UK. Further, the strategic acquisition of Solo Energy has strengthened our energy services platform to accelerate the delivery of extended energy services to our customers.

We previously announced that we were exploring options to monetise the value of a minority of the Group's meter assets. On 12 March 2020, the Group conditionally agreed to dispose of a minority of the Group's meter assets for the gross consideration of £291m. This represents £18.4m ILARR and SMS will continue to manage the disposed assets for an RPI-linked management fee of c.£0.8m.

This transaction generates considerable cash returns and demonstrates the substantial value of our smart meter portfolio. The value that this transaction delivers enables the acceleration of shareholder returns, with the proposal of a significant change to our dividend policy, detailed further below.

We remain focused on securing long-term sustainable revenue streams, supported by an efficient capital structure, and are committed to seeking additional opportunities that enable the fulfilment of our mission: to deliver the future of smart energy.

### **Our results**

Investment in our portfolio of revenue-generating assets has remained strong, reflected in the 20% increase in our ILARR to £90.1m and an overall increase in our assets under management to 3.7 million from 3.1 million at the end of 2018.

Our business delivered a resilient performance this year, despite the challenges we faced with delays in the smart meter rollout.

Whilst our statutory profitability after tax was lower than last year, our pre-exceptional EBITDA of £58.9m continued to grow, reflecting the strength of our index linked, recurring revenue base together with the significant efforts of the management team to manage our cost base in order to mitigate the impact of the rollout delays on our near-term profitability.

### **Navigating the smart meter rollout and creating opportunities for the future**

The UK smart meter rollout continues to represent a core opportunity for us over the next few years. With 16.5 million smart and advanced meters operating as at 31 December 2019, there are still c.36.5 million meters to be exchanged.

Our contracted c.2 million pipeline opportunity from existing contracts with independent energy suppliers should add a further c.£40m of ILARR. With the range of technical issues during 2019 now predominantly resolved, as further detailed in the Operational review below, our focus for 2020 is to work closely with our customers and help them deliver their smart meter installation plans efficiently and effectively.

The energy market provides a wealth of opportunities for future growth, especially as the UK continues its decarbonisation journey with a legally binding net-zero carbon emission target by 2050. A new market for the management and operation of carbon reduction ("CaRe") assets, including EV charging points and battery storage, continues to evolve and developments in this space are accelerating. We are already well positioned to respond with the strategic acquisition of Solo Energy and its FlexiGrid platform, which operates the integration of energy storage systems, renewable generation and vehicle charging into the UK's energy systems and builds out our energy management business.

## **Delivering our strategy**

During 2019 we were focused on continued growth of our ILARR, including preparations for the establishment of an asset base in CaRe assets, and overall operational efficiency through careful management of our installation capacity and engineering productivity.

The smart meter rollout will remain the core focus in the immediate future and with an increasing installed base of smart meters we continue to progress the origination of new CaRe assets. With the likely extended rollout period for smart meters, we will ensure our resources and cost base are aligned with a strong focus on operational efficiency.

Our strategic priority of capital efficiency has been the subject of a comprehensive review by the Board, to ensure we are optimising our capital structure in the face of changing markets and opportunities. The recently announced disposal of a minority of our I&C portfolio assists in the delivery of this. We have also entered into a partnership with the Columbia Threadneedle Sustainable Infrastructure Fund ("ESIF") to finance our pipeline of CaRe assets. Further details are provided in the Chief Executive Officer's statement.

## **Dividend**

Over the last few years, we have aimed to provide a progressive, through-cycle dividend that shares the rewards of our profitability and growth with shareholders and provides a sustainable return. In this context, the Board is proposing a final cash dividend of 4.58p per ordinary share for the year ended 31 December 2019 (2018: 3.98p). In addition to the interim dividend of 2.30p (2018: 2.00p), this will give a total ordinary dividend of 6.88p (2018: 5.98p), an increase of 15% on last year.

Following the minority asset disposal, the business will be in a net positive cash position on completion. This will allow us to generate significant additional value for shareholders from our existing asset base.

I am, therefore, pleased to announce an intended, new and enhanced dividend policy of 25p per share per annum. Effective from 2020, this will be payable in quarterly instalments and will increase with RPI through to 2024. Representing over three times the dividend of 6.88p in 2019, this marks the start of returning materially increased value through distribution to shareholders over the medium term.

## **Continued investment in sustainability: the environment, our people, and health and safety**

With a core Group focus on investment in assets that help reduce carbon, operating sustainably is a key focus area for us and we aim to be transparent with our investors on the impact we are having on both the environment and society around us, and our people.

In 2019, we developed a holistic view of our sustainability, quantifying our positive impacts delivered through our services, and negative impacts from our business estate and fleet. I am very proud to confirm that, in 2019, the positive services we were able to provide significantly outweighed the footprint we left behind, supported by our products and services and efforts to reduce our own footprint through fleet upgrades, property refurbishments and procurement of renewable electricity.

The success of our business is undoubtedly reliant on the continued support of our employees. We put our people first, placing considerable value on their engagement. During 2019, we refined our values and behaviours through a collaborative project, with extensive involvement from employees at all levels. We now have a clear set of values that align with our strategic objectives and future focus. I would like to thank all our employees for their hard work and commitment during the year.

The health and safety of our employees and customers continues to be a key priority. I am pleased to report that our performance over the year remained stable, despite a significant increase in our engineering workforce, with no notable detrimental changes to our accident frequency rates.

## **Coronavirus**

As the situation continues to evolve, our primary concern is for the welfare of our people. We are following the development of the coronavirus outbreak closely and have implemented several immediate measures to both protect our employees and to prepare for possible consequences of the virus. Whilst the outbreak has not yet had any direct impact on our operations, it is unclear how it will develop. It is currently difficult to assess the potential impact this could have on our 2020 business activities and results, but we will continue to follow developments closely and are prepared to take further action as appropriate.

## **Current trading and outlook**

We have demonstrated during the year our resilience in managing the short-term challenges arising from the volatility of the smart meter rollout, whilst addressing future market opportunities through strategic investment and development of our carbon reduction proposition. With the technical issues experienced during 2019 substantially behind us, and

support from BEIS in the form of a proposed extended rollout timescale to the end of 2024, we are well placed to progressively deliver the rollout in an efficient manner with our customers.

Capital efficiency remains a key strategic priority for us, ensuring we can effectively respond to market developments, and take advantage of additional opportunities, whilst also increasing shareholder value.

The years ahead hold more exciting developments for our business, with the ongoing smart meter rollout and growth in our CaRe asset base. The Board remains confident in SMS's strength and potential in the face of a transforming energy landscape.

The current year has started in line with the Board's expectations and we continue to actively engage with both existing and potential customers in securing our future order book.

## **Chief Executive Officer's statement**

### **Net-zero carbon at the heart of our activities**

The scale and urgency of global action required for climate change to be addressed has undergone a step-change during 2019. This has resulted in a governmental, business and consumer response that is likely to bring significant market disruption with the UK becoming the first major economy to legislate for net-zero carbon emissions. The impact of this will be especially evident in the energy industry, with long-term structural changes to how and where energy is generated, stored and used.

The UK's net-zero target will continue to drive public policy decisions in our industry, one of which is the need for smart meters. Smart meters are an integral part of a flexible, decentralised and decarbonised energy system – central to reducing CO<sub>2</sub> emissions and reliance on unsustainable energy sources.

Sustainability is therefore at the heart of our business. Central to the government's decision to convert the UK to smart meters is the clear impact that control over energy consumption has on reducing carbon emissions. This macro trend provides substantial opportunities for our business, and with 25 years' experience in the energy industry and a well-established IT, data and engineering platform, SMS is well positioned to take advantage of them and contribute positively towards a sustainable future through the development of CaRe assets that complement and are enabled by smart meters.

### **Strategy**

The industry trends provide a clear direction and substantial opportunity for the continued long-term success of our business, delivering and maintaining both meter and CaRe assets, which provide high-quality and secure recurring revenue streams.

To deliver this, our focus remains on the following three pillars of our strategy, on which we have made strong progress in 2019:

- securing long-term index-linked sustainable revenue streams;
- efficient operational delivery and customer excellence; and
- efficient capital structure to assist in generating shareholder value.

### ***Index-linked revenue streams***

The core focus of the Group is securing long-term index-linked, sustainable, recurring revenue streams.

We have clear visibility of our recurring revenue pipeline, with substantial opportunities to grow this further given both the continued growth in the independent energy retail sector to over 30% market share and the c.36.5million meters still to be exchanged in the industry as a whole.

### ***Operational efficiency and excellence***

In 2019 we continued to invest in engineering capacity, meter stock and IT infrastructure to support the transition to SMETS2 and ensure continual improvement in the efficiency, customer service, quality and health and safety standards with which we deliver our services.

Our IT systems are increasingly integrated with our customers', enabling growing numbers of end consumers to book meter installation appointments through their energy suppliers' "apps" and websites, or at any point in which they speak directly to their energy supplier. We continue to implement innovations which minimise and automate the touchpoints we have with end consumers during our established customer journey processes, improving the customer experience and reducing the volume of activity within our contact centre as a result.

These integrations with our customers are also important to co-ordinate customer engagement and conversion with the energy suppliers, who are taking ever greater ownership of that process in the context of regulatory targets for smart meter deployment.

The proposed extended delivery period through to the end of 2024 for the smart meter rollout will mean a smoother rollout profile ahead of us, and we have already taken steps in H2 2019 to improve productivity by increasing the amount of transactional, revenue-generating “callout” activity we provide to energy suppliers.

We will maintain a strong focus on engineering efficiency and cost discipline in 2020, aligning our resource base to the longer rollout profile, whilst ensuring we have the flexibility to ramp up installation rates to meet the significant opportunities ahead.

#### ***Capital structure optimisation and shareholder value***

Whilst we have sufficient funding to meet our immediate contracted opportunity pipeline, with net debt of c.£220m at 31 December 2019 from a facility, at that time, of £420m, we continually review our financing to ensure we are optimising our capital structure.

We have successfully agreed the conditional disposal of a minority of our I&C portfolio, consisting of £18.4m of I&C ILARR for £291m gross proceeds to funds managed by Equitix Investment Management Limited. SMS will continue to manage the disposed assets with an average age of c.4.7 years for £0.8m of RPI-linked management fees.

In addition, we have retained a portion of I&C assets and will continue to participate in the I&C market through our utilities connections business. At completion, the disposal generates a net positive cash position for the Group, enables acceleration in dividend policy, enhances ability to maximise future meter ILARR opportunities, demonstrates value of meter assets and provides additional funding flexibility. We are well placed to accelerate both growth and dividends whilst maintaining prudent leverage through the investment cycle.

- **Growth funding**

We have several funding options which provide significant flexibility to maximise opportunities in the smart metering space: long-term cash generation from our mature meter portfolio (post dividend payments), a revised £300m RCF on attractive terms, incremental cash generated from deployment of new assets and further capital optimisation opportunities.

We have originated a strong pipeline of opportunities in CaRe assets and have partnered with ESIF to provide funds for the development of these assets. SMS’s revenues and cash flows from these assets and services are expected to increase over time.

- **Sustainable and long-term dividend policy**

As part of our recent announcement of a minority asset disposal, we also proposed a revised, sustainable and long-term dividend policy. This starts at 25p per share for 2020, payable quarterly and with a partial scrip alternative, and then growing at least in line with RPI per annum during the meter growth phase to 2024. The dividends are covered by cash generated from our retained existing meter and data assets, providing strong forward visibility.

The Board believes there is further dividend upside potential to the dividend policy summarised above.

#### **2019 performance**

The business experienced challenges in 2019 during the market’s transition from SMETS1 to SMETS2, with industry installation run rates remaining largely flat throughout the year as a consequence. “Radio frequency” interference issues in the northern region of the rollout proved a significant impediment to mobilisation of SMETS2 meter installations, whilst the end date for SMETS1 meter installations meant there were no viable alternatives.

With these technical issues relating to radio frequency interference now substantially resolved, SMETS2 meters are being installed in increasing volumes. The solution continues to mature as a result, with c.4m SMETS2 meters connected to the network across the industry as of 27 February 2020, although these have largely been fitted by the Big Six UK energy suppliers. The government has consulted to extend the smart meter rollout to December 2024, reflecting a more realistic and pragmatic approach. We believe this provides greater certainty to plan and deliver the rollout in an efficient manner with our customers and expect the rollout profile to be more evenly spread through to 2024 as a result. With compulsory annual installation targets and the introduction of a stricter regulatory regime for energy suppliers, we will continue to work closely with all our customers to mobilise and deliver their rollout requirements.

Some independent energy suppliers are still finalising integrations with the Data Communications Company (DCC) and end-to-end testing, with their readiness to commence mass SMETS2 meter rollouts at varying stages of development.

The industry issues in 2019 led to engineer productivity related challenges, particularly in H1, which had a short-term impact on profitability. Nonetheless, careful management of our operational activities and a strong focus on engineering efficiency enabled us to significantly reduce the impact on profitability. This is a testament to the strength and resilience of our business model that, despite these challenges, the execution of our strategy delivered a robust financial performance highlighted by a growth of 20% in our primary financial KPI - ILARR.

We ended 2019 with £90.1m of ILARR. This growth was primarily driven by the smart meter exchange programme, with recurring revenue from domestic smart meters increasing by 40% in 2019 from £27.1m to £38.1m. We have also continued growth in all our other segments with I&C meters £21.2m (2018: £19.0m) at 31 December 2019, of which £18.4m have been subsequently sold, data assets £12.3m (2018: £12.2m) and traditional domestic meters £18.6m (2018: £17.1m). As we continue to roll out smart meters, recurring revenue from our traditional meters will steadily reduce.

## Continued growth and new opportunities

### **Domestic smart meters and data**

We have a contracted order pipeline of c.2 million meters from our independent energy supplier customers which will initially add c.£40m to our ILARR. SMS is also well placed, operationally and financially, to take advantage of additional opportunities which we see beyond this pipeline. We continue to focus on leveraging our valued turnkey services to originate long-term, index-linked return on our capital investment in meter assets.

The rollout of smart meters has created additional data opportunities for SMS. We are focused on growing our data services by launching elective half-hourly settlement and SMETS2 firmware management services for our energy supplier customers. We believe this is a substantial market opportunity in its own right, and the revenues originating from these activities are also index linked and recurring in nature.

### **CaRe assets**

We also see significant growth opportunities in CaRe assets from within our energy management division. Established over the last 25 years, we have developed a strong IT, Data and Energy platform which coupled with our end-to-end turnkey solution and industry-wide partnerships provides us with significant opportunities and competitive advantage.

SMS is well placed to support the UK government's net zero ambition by 2050. We can do this by continuing to leverage our well-established energy services business as the UK transitions to a more sustainable and low-carbon economy. Our partnership with ESIF provides capital support for SMS's identified pipeline and future opportunities of CaRe assets. Such initial CaRe assets include energy efficiency systems (such as LED lighting, data and controls), energy storage, distributed generation, and EV charging infrastructure.

This year marks our 25th anniversary, which is testament to our secure business foundation and long-term business model. We are committed to creating a resilient energy infrastructure for the future, focused on delivering long-term value for all our stakeholders.

## Operational review

### **Asset management division**

Summary	2019	2018	Growth
ILARR	<b>£90.1m</b>	75.3m	+20%
Revenue	<b>£82.9m</b>	£65.5m	+27%
Depreciation adjusted cost of sales*	<b>(£5.9m)</b>	(£5.4m)	+10%
Depreciation adjusted gross profit*	<b>£77.0m</b>	£60.1m	+28%
Depreciation adjusted gross margin*	<b>93%</b>	92%	+1%
Capex on meters	<b>£95.2m</b>	£128.2m	-26%

\*Excludes depreciation on revenue-generating assets, recognised within cost of sales. Refer to the Financial review for definitions and details on the Group's alternative performance measures.

## **Our focus**

The asset management division is focused on growing our secure, long-term, index-linked and sustainable revenue streams. Our primary strategic objectives are to:

- grow our ILARR, focused on recurring rental from the UK smart metering market opportunity;
- manage and track all assets through their life, controlling capital deployment and return on investment; and
- continually ensure a capital-efficient structure, to maximise the opportunity available to us from the smart meter rollout.

Through our industry accredited services, we continue to work with energy suppliers to support them in managing the challenges and opportunities smart metering brings. For example, by growing our data and accredited industry settlement (half-hourly data) services and providing firmware management test labs and services for SMETS2 meters. These are opportunities for us to continue to grow our ILARR, and to play a critical role in the realisation of the smart energy grid, and a greener, low-carbon energy network.

## **Performance summary**

- ILARR increased by £14.8m, a 20% increase, to £90.1m.
- Our mature I&C and smart meter asset portfolios contributed £59.2m to the ILARR, with our smart meter portfolio growing 44% to over 1.2 million meters.
- Further opportunity beyond this pipeline with contracted and potential customers.
- Focus on capital efficient structures, ensuring sufficient financial capacity to maximise opportunities in the smart meter rollout whilst delivering secure and growing dividends for the long term.

Our smart meter portfolio grew 44% to 1.2 million meters, adding 369,000 smart meters in the year (300,000 from our own installation activity), and we expect installation run rates to be more evenly spread following the BEIS extension of the smart meter rollout to 2024.

Data recurring revenue is in line with last year at £12.3m (2018: £12.2m). This reflects the maturity of the I&C market where we predominantly provide these services and our decision to step back from some domestic data services, which require low-margin transactional meter-read activity. We believe there is still an opportunity for data services, both in the I&C and Domestic markets, particularly in supporting energy suppliers with the settlement of half-hourly data from smart meters (which does not require manual meter readings).

## **Market conditions**

Whilst there have been pressures on the deployment of smart meters, the broader market continues to transform at a rapid pace, with continued growth in the “independent” energy supplier market, which now supplies over 30% of all customers. This was before the recent acquisition of the SSE domestic retail business by Ovo Energy, which had c. 12% market share. The independent market segment with which SMS is most heavily engaged, benefits from our turnkey approach including both installation and active asset management. There are significant opportunities for us to grow our market share beyond our contracted order book.

We have continued to see some smaller energy suppliers struggle financially. In some cases, Ofgem’s Supplier of Last Resort (SoLR) has been implemented and, as a result, there has been further consolidation in the market. This brings a small amount of risk to SMS in respect of short-term credit risk to rental payments from energy suppliers. However, the SoLR process has proven that, where a more creditworthy supplier is appointed to take over a supplier portfolio, then we have a standard industry process that transfers our meter points to the new supplier and protects our rental revenue streams going forward. Over the life of these long-term assets and on a portfolio basis, this provides a secure backdrop to the significant capital we deploy.

Our well-established turnkey integrated service remains unique in the market and is a strong foundation for our continued growth. We see competition in the market from other asset financing businesses, and some energy suppliers using the smart meter rollout extension to segregate some parts of the delivery process – most notably taking greater ownership over the customer journey.



## Asset installation division

Summary	2019	2018	Growth
Revenue (external)	<b>£22.4m</b>	£26.6m	-16%
Cost of Sales	<b>(£28.0m)</b>	(£20.5m)	-37%
Gross profit	<b>(£5.6m)</b>	£6.1m	-193%
Gross margin	<b>(25%)</b>	23%	-48%
Net portfolio additions – smart and I&C meters*	<b>313,000</b>	449,000	-30%

\*Net portfolio additions include removals. 2019 net portfolio additions of 313,000 exclude 69,000 smart meters acquired from a customer during the year.

## Our focus

The installation division is focused on operational excellence and efficiency. Our primary strategic objectives are to:

- safely deliver the installation of meter assets which provide long-term recurring revenue to our business;
- align our engineering capacity and installation profile over the proposed, extended BEIS rollout period, using technology to drive efficiency improvements and an improved customer experience and appointment booking process; and
- reduce the carbon footprint of our delivery – in particular, from our vans by implementing more dynamic scheduling and introducing electric vans where practical.

The installation division is working with our customers to trial the installation of next-generation asset classes, in particular smart home and domestic EV charging point devices which can be installed at the same time as smart meter installations.

## Performance summary

- Completed operational, technology and supply chain transition from SMETS1 to SMETS2 in 2019 and supported investment in capacity platform.
- Technology enhancements that provide online supplier booking portals, to increase portfolio conversion and reduce operational expenditure.
- Successful navigation through third-party challenges e.g. Radio Frequency interference issues in northern region resolved and SMETS2 meters being deployed on a national basis.
- Maintenance of a reliable engineering resource base, supported by in-house training academy.
- Continual productivity improvements in H2, supported by increase in chargeable transactional activity.
- BEIS consultation, proposing an extension to 31 December 2024 means SMS expects a smoother installation profile, with engineering business being sized accordingly and sufficient flexibility through supply chain to manage peak demands.
- Working closely with domestic and small I&C energy suppliers to meet rollout obligations.

2019 was a challenging year for the smart meter installation market, with the government having mandated an end date for SMETS1, effectively enforcing a transition to SMETS2. This was then followed by a technical Radio Frequency interference issue with the SMETS2 meter installations – which connect immediately to the central DCC – leading to the inhibition of installations, most notably in the north of England and Scotland.

In addition, each energy supplier's readiness for SMETS2 has varied, in particular regarding their end-to-end connectivity to the DCC to enable smart meters to be installed and commissioned. The largest "Big Six" suppliers have typically been the most advanced, with some independent energy suppliers, particularly the small and medium-sized ones, still some way behind.

Overall, therefore, the industry has seen a slow-down in smart meter installations in the year.

Therefore, whilst SMS has had the engineering capacity to fulfil initially forecasted customer demand during 2019, actual installation numbers and hence productivity have proven to be challenging. This resulted in smart meter installations remaining relatively flat over the year.

Working closely with our customers and supply chain, these radio frequency technical issues have been resolved. In addition, we, have continued to collaborate with all our customers to ensure their systems and DCC connectivity are fully operational for the mass rollout. We have also taken steps throughout 2019 to address the productivity challenges, particularly increasing the volume of chargeable transactional activity in the second half of the year.

Whilst some technical challenges remain, predominantly around the use of SMETS2 meters in prepayment situations, firmware versions and availability of meter variants, DCC and SMETS2 are increasing in maturity and reliability. We are increasingly optimistic regarding the continued deployment of these solutions through the smart meter rollout – with c.36.5 million smart meters still to be exchanged across the industry by 2024.

## Market conditions

The BEIS consultation on the smart meter rollout proposed extending the rollout to 31 December 2024 with a target of 85% of all meters being exchanged by this point. It has also indicated an intended stronger underlying regulatory regime.

Energy suppliers were initially obliged to take all reasonable steps to offer and deliver smart meters to all customers by the end of 2020, whereas now they have to meet annual compulsory targets in order to adhere to the revised programme end date.

This proposed extension reaffirms the importance of the smart meter rollout to the future of the UK energy system. We now expect to see a smoother installation profile through the course of the rollout and are sizing our engineering business accordingly to deliver our contracted meter installation pipeline. This includes allowing sufficient flexibility in our model to meet customer peak demand and additional opportunities from existing and potential new customers.

Through our accredited training academy, we are engaged in industry-wide initiatives to continually improve health and safety (H&S) performance, with smart meter installations providing an ideal opportunity to identify any existing quality issues in the meter or the incoming electrical/gas supply.

## Energy management division

Summary	2019	2018	Growth
Revenue	<b>£9.0m</b>	£6.5m	+39%
COS	<b>(£6.8m)</b>	(£5.1m)	+35%
Gross profit	<b>£2.2m</b>	£1.4m	+58%
Gross margin	<b>24%</b>	21%	+3%
Value of utilities under management	<b>£320m</b>	£250m	+28%

## Our focus

The well-established energy management division is focused on deploying assets and solutions which help our customers reduce their energy consumption and carbon footprints, thereby helping them in their journey to net zero. Our primary strategic objectives are to:

- build and deliver a capital project pipeline to deploy services and assets to reduce our customers' carbon footprints;
- generate long-term, secure recurring returns from energy efficiency, distributed generation, storage and EV charging projects; and
- partner with multiple distribution channels to maximise this project pipeline opportunity.

A strong pipeline of CaRe opportunities has been identified based on ongoing trials and projects, which are at various stages of discussions. Through our new funding partnership with ESIF, we are able to deploy capital into these CaRe projects without diverting the cash flows from our meter assets business, resulting in cash positive returns to the Group.

SMS's revenues and cash flows from CaRe assets and services are expected to increase over time, with no funding obligation and no significant cost needed to accelerate growth. This provides an additional lever for further rebasing of future dividends.

## Performance summary

- Revenue and gross profit increased in line with expectations from delivery of energy efficiency strategies and energy management services.
- Strategic positioning to deliver capital projects which improve energy efficiency and reduce carbon emissions, through investment in new generation, storage, electric vehicle assets and energy services projects.
- Investment in Solo Energy, with "FlexiGrid" technology platform which integrates distributed generation, battery storage and EV chargers across domestic and commercial buildings to create a virtual power plant (VPP).
- This VPP enables SMS to control and manage the long-term revenue streams from these new asset classes.

- Industrial expertise, customer relationships and extensive, highly skilled engineering base demonstrated through long-term blue-chip customer relationships.

Our energy management division has performed well in 2019, continuing to specialise in working with I&C customers, particularly those with large, complex, multi-site portfolios. We advise on and implement effective strategies that reduce both energy costs and consumption, by providing a full range of energy consultancy services, including bill investigation, bureau, energy reduction and environmental management.

Our approach is built on data, using our data analytics platforms and often working closely with our accredited industry data services, to identify opportunities to reduce our customers' carbon footprints.

We have continued in 2019 to deliver several capital projects, funded by customers, which reduce energy intensity, such as an LED lighting project and smart controls project for a major UK hotel chain. We have a strong pipeline of activity and other similar projects which have a positive outlook for the continued growth of these services in coming years, intended to be funded through our infrastructure fund partnership.

We have established a full turnkey end-to-end delivery, supported by strong industry relationships. The increased urgency to address net-zero greenhouse gas emissions provides substantial opportunity for our business.

### **Market conditions**

There are several factors driving the emergence of smart technologies and a new way of delivering and using energy including:

- the ongoing digitisation of our energy system;
- the introduction of the net-zero carbon target for 2050;
- the resulting renewed public policy focus on the climate change agenda; and
- the rapidly shifting business, consumer and investor sentiment.

Energy efficiency remains the first and most important step in this hierarchy. However, this data-driven transformation is expected to have a profound impact on how and where we generate, store and use energy – making it more dynamic, connected and sustainable. In particular, the necessity for increasing levels of renewable generation and peak electric vehicle charging demand (especially at the local level) requires new assets, capital investment and software data controls platforms to respond to energy and price signals.

Whilst smart meters are at the heart of this transformation, by enabling two-way flow of energy and smart and dynamic time-of-use tariffs, SMS has the proven knowledge and platform to work with end customers and energy suppliers to deliver these new asset classes.

Our investment in Solo Energy also provides us with a cloud-based energy flexibility IT platform – FlexiGrid – to control and aggregate data and revenue from generation and battery storage assets. This fully integrated platform enhances our ability to provide a comprehensive end-to-end service proposition to our established industrial, domestic and energy services customer base.

By integrating energy storage, renewable generation and vehicle charging into the UK energy system, FlexiGrid can help shape consumer demand to follow renewable energy supply and operate as a VPP. This fully integrated platform enhances our ability to provide a comprehensive end-to-end service proposition to our established industrial, domestic and energy services customer base and will address the market disruption affecting the UK and global energy system. Crucially, it provides the technology platform to support the deployment of these new infrastructure CaRe asset classes.

We continue to fully integrate the Solo Energy platform with our wider energy services and leverage our well-established energy services foundations to remain at the centre of the energy system as we transition to a more sustainable and low-carbon economy.

### **Financial review**

Given the challenges we have faced during 2019, primarily driven by the continued industry-wide issues and delays surrounding the smart meter rollout, I am very pleased to be able to present a set of financial results that are in line with market expectations.

Whilst our statutory profit from operations indicates modest growth, the continued significant investment in our portfolio of revenue-generating assets is driving a 20% increase in our key performance measure, ILARR, to £90.1m. Our underlying performance, as measured by pre-exceptional EBITDA, has increased by 14% against a backdrop of

the volatility of the smart meter rollout and lower installation volumes, highlighting the strength of our underlying business model in investing in assets that generate recurring revenue.

We fundamentally manage the business on a long-term basis, in line with our strategic priorities, and focus on delivering secure returns for our shareholders. We exit the year comfortable with our results and performance.

Well placed for the next phase of our growth and development, the conditional disposal of a minority of our meter asset portfolio on 12 March 2020 realises significant value for the Group and there is a fundamental positive impact on our future strategy, as discussed further within this report.

## Reconciliation of reported to underlying results

SMS uses alternative performance measures, defined at the end of the Financial Review, to present a clear view of what the Group considers to be the results of its underlying, sustainable business operations. By excluding certain items, this enables consistent year-on-year comparisons and aids with a better understanding of our business performance.

A reconciliation of these performance measures is disclosed below:

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m	Percentage change
<b>Annualised recurring revenue</b>	<b>90.1</b>	75.3	20%
<b>Group revenue</b>	<b>114.3</b>	98.5	16%
<b>Statutory profit from operations</b>	<b>13.8</b>	11.1	
Amortisation of intangibles	1.5	2.6	
Depreciation	35.1	21.8	
<b>Statutory EBITDA</b>	<b>50.4</b>	35.5	42%
Exceptional items (EBITDA related)	8.5	16.1	
<b>Pre-exceptional EBITDA</b>	<b>58.9</b>	51.6	14%
Net interest (excl. exceptional)	(8.2)	(4.7)	
Depreciation	(35.1)	(21.8)	
<b>Underlying profit before taxation</b>	<b>15.6</b>	25.1	(38%)
Exceptional items (EBITDA)	(8.5)	(16.1)	
Exceptional items (interest)	(0.1)	(1.0)	
Amortisation of intangibles	(1.5)	(2.6)	
<b>Statutory profit before taxation</b>	<b>5.5</b>	5.4	2%
Taxation	(1.5)	(0.9)	
<b>Statutory profit after taxation</b>	<b>4.0</b>	4.5	(11%)
Amortisation of intangibles	1.5	2.6	
Exceptional items (EBITDA and interest)	8.6	17.1	
Tax effect of adjustments	(1.4)	(3.4)	
<b>Underlying profit after taxation</b>	<b>12.7</b>	20.8	(39%)
Weighted average number of ordinary shares (basic)	112,446,154	112,408,338	
<b>Underlying basic EPS (pence)</b>	<b>11.30</b>	18.46	
Weighted average number of ordinary shares (diluted)	113,269,412	113,465,235	
<b>Underlying diluted EPS (pence)</b>	<b>11.22</b>	18.29	

## Revenue

	31 December 2019 £m	31 December 2018 £m	Percentage change
Asset management	82.9	65.5	27%
Asset installation	22.4	26.6	(16%)
Energy management	9.0	6.5	39%
<b>Group revenue</b>	<b>114.3</b>	98.5	16%

Total ILARR increased by 20% to £90.1m as at 31 December 2019 compared to 31 December 2018, in line with our expectations. Consistent with the prior year, most of the growth was seen in the electricity meter division, with an increase in ILARR to £28.1m at 31 December 2019 (31 December 2018: £20.3m). The installation of dual fuel meters as part of the smart meter rollout favours higher growth in our younger electricity portfolio, when compared with our historical gas-weighted portfolio.

The overall growth in ILARR reflects the flow through impact of new contract wins from 2018 and the first quarter of 2019, and growth in the meter estate, together with the combined effect of increases in RPI and rental rates for deemed non-contracted customers. We continue to actively engage with both existing and potential customers in securing our future order book.

Group revenue rose 16%, driven primarily by continued growth in the asset management and energy management divisions, offset by a decline in asset installation revenues. Whilst installation run rates were slower than anticipated through the year, for us and the wider market, our domestic smart meter portfolio has still increased, generating additional revenue.

Together with a favourable increase in the RPI in April 2019, and a pricing increase on deemed non-contracted customers, revenue has increased by 27% in the asset management division to £82.9m (2018: £65.5m).

Energy management revenue has increased 39% to £9.0m (2018: £6.5m), which continues to be attributable to the capital projects in progress for a large hotel chain. Over 190 sites were completed in 2019 as part of the ongoing energy-efficient lighting project; and, towards the end of the year, we embarked on a second significant project for the same hotel chain, delivering smart heating controls.

Asset installation revenue was £22.4m (2018: £26.6m) reducing largely due to legacy installation-only work for third parties coming to an end in the first half of the year, in line with the Group's decision to reallocate internal engineering resource to fit the SMS portfolio of smart meters. The decline in installation revenue has been partially offset by higher volumes of emergency and transactional work on SMS's portfolio of traditional meters, which have required direct replacement whilst energy suppliers become SMETS2 ready.

### **Gross margins**

Overall, the depreciation-adjusted gross margin at a Group level remained broadly consistent at 64% (2018: 63%). SMS includes depreciation on revenue-generating assets within cost of sales and removing this from the margin analysis provides a better comparison of underlying trading performance year on year.

Whilst the Group has experienced a higher than expected proportion of installation costs that are unable to be capitalised, revenues from transactional work have also been higher than expected, providing an offset that has kept the overall depreciation-adjusted gross margin steady.

The depreciation-adjusted gross margin for asset management has also remained steady at 93% (2018: 92%), reflecting the growth in the underlying asset base. The gross margin, including depreciation, has decreased by 6% from 61% to 55%, primarily as a result of a change to a depreciation related accounting estimate, made with effect from 1 January 2019, in relation to SMS's traditional meter assets. As a result, there is an additional £7.3m recognised within depreciation in cost of sales on a statutory basis – see note 1(a) to the financial statements for further details.

The asset installation business reported a negative gross profit margin of 25% (2018: positive 23%). This primarily reflects the Group-wide strategy to focus its internal resources on the smart meter rollout, with legacy external installation contracts coming to an end at the beginning of the year, reducing external revenues and removing the contribution to profitability seen in prior years.

Through the first half of 2019 there was continued investment made in retaining the Group's installation capacity to ensure the business was appropriately positioned to benefit from the run rates initially anticipated from progression to the main SMETS2 phase of the smart meter rollout. Gross profit margin for the asset installation business saw a significant reduction as a result to negative 48% in H1. As initial installation targets in the market started to look increasingly challenging, attention was turned to controlling our operating cost base in order to increase efficiency in the labour force. As a result, the gross profit margin improved to negative 6% in H2. Cost control will be a key focus through 2020 and beyond. It remains key that our overall capacity is right sized in order to meet customer demand efficiently. The full year reported gross margin for the asset installation business, whilst negative, thus reflects management's cost control in the latter part of the year.

The energy management gross margin has increased to 24% (2018: 21%), supported by the commencement of a smart heating controls project at slightly higher margins.

### **EBITDA**

Pre-exceptional EBITDA increased to £58.9m (2018: £51.6m) with statutory EBITDA increasing to £50.4m (2018: £35.5m). This demonstrates that, whilst costs have been incurred to create capacity to support future growth, our increase in revenue has been high enough to offset this.

The Group's tactical retention of its internal engineering workforce, the successful setting up of a dedicated contact centre to help drive the business through the smart meter rollout and ongoing development of key IT platforms that underpin the end-to-end service offering, have increased cost of sales and general overheads in 2019 as a result.

Other costs in the year which impacted our underlying profitability include a £0.8m bad debt write off in relation to smaller independent energy suppliers that have ceased trading and been transferred to much larger energy suppliers under the SoLR mechanism. The last two years have seen a large number of independent energy suppliers enter administration, as a result of a failure to settle their financial obligations with Ofgem. This trend is not anticipated to continue to the same extent into 2020 and beyond. We have also incurred £3.8m of bad debt expense arising from individually impaired trade receivable balances with specific customers.

Despite these additional costs, pre-exceptional EBITDA continued to grow as a result of the strength of our index linked, recurring revenue base.

Statutory EBITDA has increased, due to a flow through of the above points together with lower overall operating exceptional costs of £8.5m, as compared with £16.1m in the prior year. These are detailed further below.

### **Exceptional items**

The operating charge to the income statement in respect of exceptional items of £8.5m continues to be largely driven by net losses on our meter portfolio of £6.0m, arising from the removal of traditional meters and a proportion of SMETS1 compliant smart meters.

Technical communication issues for some SMETS1 meters on supplier churn have continued through 2019, with the enrolment and adoption process into the DCC delayed into 2020. As a result, the Group has continued to see a very small proportion of SMETS1 meters removed from the wall. As these removals are attributable to the temporary industry transition period, management has taken the judgement to recognise losses arising on the disposal of these meters as exceptional.

In the prior year, we incurred an exceptional charge of £5.6m in relation to the impairment of the traditional meter portfolio, reflecting a higher volume of removals than anticipated and a reduction in future rental income from the reducing portfolio of meters remaining on the wall. There was no similar impairment charge in 2019.

Of the remaining exceptional cost, £2.0m relates to legal and professional costs incurred in the reported sale process of a minority of the Group's meter assets, detailed further below.

### **Operational and pre-tax profits**

Depreciation costs on general property, plant and equipment, excluding meter assets, have increased by £2.2m to £3.6m (2018: £1.4m). This is largely driven by the decision to purchase the Group's fleet of vans, previously leased on an operating basis. £0.9m of additional depreciation has also been recognised as a result of the implementation of IFRS 16; see note 29 to the financial statements for details.

The BEIS consultation, that proposed a new monitoring framework for the smart meter rollout through to 31 December 2024, was still outstanding at the balance sheet date and, therefore, no change to the useful economic life of the traditional meter portfolio has been made in 2019. Upon ratification of the consultation in 2020, management intends to revise the useful economic life through to 31 December 2024 to align with the market. This will be applied prospectively and will see the annual depreciation charge on the traditional meter portfolio decrease.

The net interest charge is £8.3m (2018: £5.7m), reflecting higher average net debt as a result of the continued investment in assets.

Underlying profit before taxation has decreased by 38% to £15.6m. The Group's overall depreciation charge, largely driven by the meter portfolio, and our largest non-cash cost item, has grown from £21.8m to £35.1m. Together with a flow through of the above points, this has resulted in a drop at the pre-tax level. Management is optimistic that pre-tax profits will start to show an upwards trajectory as the smart meter rollout picks up pace and, in the meantime, uses ILARR, revenue and pre-exceptional EBITDA as the key performance measures of the business.

### **Taxation**

The effective tax rate on statutory profits was 26.81% (2018: 16.6%). The increase in the effective rate is driven primarily by an increase in permanent differences from disallowable items, including legal and professional costs incurred in the sale process of a minority of the Group's meter assets.

The Group's capital expenditure as it pertains to meter assets qualifies for capital allowances, providing the Group with tax relief on such expenditure. These allowances are claimed in the tax year in which the asset is acquired and

set against taxable profit for that year, thus reducing the total tax payable. As a result, the Group was not tax paying in either the current or prior year.

The Group's deferred tax balance of £13.8m is primarily made up of £11.7m in respect of accelerated capital allowances.

### **Earnings per share (EPS)**

Underlying basic EPS, which excludes exceptional costs, amortisation of intangibles and their associated tax effect is 11.30p (2018: 18.46p), reflecting the underlying profitability of the Group. Statutory earnings per share decreased to 3.56p (2018: 3.97p) as a result of lower statutory profits for the reasons detailed above.

Diluted EPS does not vary significantly from basic EPS; a small decrease is seen as a result of the dilutive impact of shares issuable in the future to settle the Group's share scheme obligations.

### **Dividend**

With regard to the 2019 final dividend, the Board has continued to pursue a progressive dividend policy, aiming to increase the dividend proposed by c.15% on its prior period comparative.

The Directors recommend a final dividend of 4.58p per share (2018: 3.98p), bringing the total dividend payable in respect of the year to 6.88p per share (2018: 5.98p), an increase of 15%.

The total final dividend is expected to total c. £5.2m and, if approved, will be paid on 4 June 2020 to shareholders on the register at 24 April 2020, with an ex-dividend date of 23 April 2020.

### **Cash flow**

The Group generated an operating cash inflow of £42.4m (2018: £40.0m), supported by underlying revenues and good cash collection.

There has been a significant increase in inventory, with the strategic purchasing of SMETS2 meters to ensure SMS can meet forecast installations in the first part of 2020.

Capital expenditure on property, plant and equipment was £101.7m (2018: £132.6m), excluding right-of-use asset additions of £4.9m. Of this, £95.2m has been used to purchase revenue-generating assets. This capital expenditure is lower than the prior year as a result of lower than anticipated installation run rates throughout 2019 as well as a lower unit cost for SMETS2 meters compared to SMETS1.

A further £6.9m investment has been made in intangible assets. This includes development of software to support the installation business, together with investment in a Group-wide Enterprise Resource Planning system that will consolidate, integrate and update various support systems.

A £1.0m cash outflow was made for the acquisition of Solo Energy Limited, a block chain energy flexibility IT platform. There has been a £97.9m net cash inflow from drawdowns on the loan facility in the year. £9.2m of finance costs have also been paid (2018: £4.8m), including £3.1m of arrangement fees in relation to the new facility.

### **Financial resources**

With further growth anticipated as the UK domestic smart meter rollout continues, SMS has access to sufficient funding to accelerate installation in line with market demand.

On 21 December 2018 a new banking facility was signed, providing the business access to £420m on a fully revolving basis over the next five years. The first drawdown under this new facility was on 3 January 2019, and at that date the Group's obligations under the previous facility were settled.

At 31 December 2019, utilisation of the new facility totalled £269.3m, net of £2.5m arrangements fees which will be amortised over the term of the facility. No principal repayments are required until 2022, providing us with greater flexibility during the current industry transition period.

Net debt was £219.2m at 31 December 2019, £77.2m higher than at 31 December 2018, primarily as a result of increased funds drawn down from the Group's banking facility for the purchase of revenue-generating assets. The Group's available cash and unutilised element of the revolving credit facility stood at £200.8m (2018: £278.0m). The Group had cash in bank of £50.1m at 31 December 2019 (31 December 2018: £30.0m).

### **Disposal of a minority of the Group's I&C portfolio (the "Disposal")**

In respect of the 2019 financial statements, this transaction represents a non-adjusting post-balance sheet event, disclosed further in note 28 to the financial statements. It was deemed that the transaction at 31 December 2019 was

not highly probable and, therefore, it did not meet the Held for Sale criteria under IFRS 5 at this date. The effect of the Disposal will be accounted for in our financial statements for the year ended 31 December 2020.

The Disposal, generating gross proceeds of £291m, fully resets the Group's leverage, resulting in a positive net cash position versus net debt to pre-exceptional EBITDA of 3.7x at 31 December 2019. Forming the core of our strategy going forward, the size of proceeds received for the disposed portfolio of c.187,000 I&C meter assets reinforces the inherent value present within our meter assets, with their index-linked long-term cash flows and limited maintenance requirements.

Following the deduction of transaction and other expenses, and subject to completion, the Group expects to receive net cash consideration of £282 million which, together a revised debt facility, significantly enhances our ability to maximise domestic smart meter opportunities and secure additional ILARR. The Disposal is expected to result in a gain on disposal of £193m, which will be classified as an exceptional item in the Group's financial statements.

It is intended that the proceeds from the Disposal will be used, in part, to settle our existing loan facility and an amended £300m revolving credit facility will be established on the same terms. This provides significant headroom to manage the business going forward on a low leveraged basis and the Group will have several funding options, providing flexibility to maximise growth in a capital efficient way.

The Disposal also enables us to announce an intended new enhanced dividend strategy of 25p per share, increasing at least with RPI through to 2024. This revised dividend policy seeks to provide SMS shareholders with a long-term and secure dividend pay-out, underpinned by the Group's highly sustainable, annuity-style cash flows.

A key feature of the Disposal is that we will continue to manage the portfolio of disposed assets for the new owners, generating annual RPI-linked recurring management fees of £0.8m for these services. We will still apply our knowledge and expertise in relation to managing the portfolio as we do for other third-party meter owners.

#### Definitions of alternative performance measures

Alternative performance measure	Definition
Index-linked annualised recurring revenue	The revenue being generated from meter rental and data contracts at a point in time. Includes revenue from third-party managed meters.
Depreciation-adjusted gross profit	Statutory gross profit less depreciation on revenue-generating assets, recognised within cost of sales.
Depreciation-adjusted gross profit margin	Depreciation-adjusted gross profit divided by statutory revenue
Pre-exceptional EBITDA	Statutory EBITDA excluding exceptional items. <sup>1</sup>
Underlying profit before taxation	Profit before taxation excluding exceptional items and amortisation of intangibles.
Underlying profit after taxation	Profit after taxation excluding exceptional items and amortisation of intangibles and the tax effect of these adjustments.
Underlying basic EPS	Underlying profit after taxation divided by the weighted average number of ordinary shares for the purposes of basic EPS.
Underlying diluted EPS	Underlying profit after taxation divided by the weighted average number of ordinary shares for the purposes of diluted EPS.
Net debt	Total bank loans less cash and cash equivalents. Excludes lease liabilities recognised under IFRS 16.

1. Exceptional items are those material items of income and expense which, because of the nature or expected infrequency of the events giving rise to them, merit separate presentation on the consolidated income statement.



**Consolidated income statement**  
For the year ended 31 December 2019

		2019 Before exceptional items £'000	2019 Exceptional items <sup>1</sup> £'000	2019 Total £'000	2018 Before exceptional items £'000	2018 Exceptional items £'000	2018 Total £'000
Notes							
Revenue	2	114,281	—	114,281	98,492	—	98,492
Cost of sales	3	(72,217)	—	(72,217)	(51,333)	(5,612)	(56,945)
<b>Gross profit</b>		<b>42,064</b>	<b>—</b>	<b>42,064</b>	<b>47,159</b>	<b>(5,612)</b>	<b>41,547</b>
Administrative expenses	3	(25,514)	(8,527)	(34,041)	(21,263)	(10,529)	(31,792)
Other operating income	3	5,726	—	5,726	1,330	—	1,330
<b>Profit from operations</b>	3	<b>22,276</b>	<b>(8,527)</b>	<b>13,749</b>	<b>27,226</b>	<b>(16,141)</b>	<b>11,085</b>
Finance costs	5	(8,461)	(104)	(8,565)	(4,962)	(996)	(5,958)
Finance income	5	278	—	278	224	—	224
<b>Profit before taxation</b>		<b>14,093</b>	<b>(8,631)</b>	<b>5,462</b>	<b>22,488</b>	<b>(17,137)</b>	<b>5,351</b>
Taxation	6	(2,584)	1,119	(1,465)	(3,835)	2,948	(887)
<b>Profit for the year attributable to owners of the parent</b>		<b>11,509</b>	<b>(7,512)</b>	<b>3,997</b>	<b>18,653</b>	<b>(14,189)</b>	<b>4,464</b>

1 Refer to note 3 for details of exceptional items.

The profit from operations arises from the Group's continuing operations.

Earnings per share attributable to owners of the parent during the year:

	Notes	2019	2018
Basic earnings per share (pence)	7	3.56	3.97
Diluted earnings per share (pence)	7	3.53	3.93

**Consolidated statement of comprehensive income**  
For the year ended 31 December 2019

	2019 Before exceptional items £'000	2019 Exceptional items £'000	2019 Total £'000	2018 Before exceptional items £'000	2018 Exceptional items £'000	2018 Total £'000
<b>Profit for the year</b>	<b>11,509</b>	<b>(7,512)</b>	<b>3,997</b>	<b>18,653</b>	<b>(14,189)</b>	<b>4,464</b>
<b>Other comprehensive income</b>						
Exchange differences on translation of foreign operations <sup>1</sup>	(66)	—	(66)	—	—	—
<b>Other comprehensive income for the year, net of tax</b>	<b>(66)</b>	<b>—</b>	<b>(66)</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Total comprehensive income for the year attributable to owners of the parent</b>	<b>11,443</b>	<b>(7,512)</b>	<b>3,931</b>	<b>18,653</b>	<b>(14,189)</b>	<b>4,464</b>

<sup>1</sup> May be reclassified to profit or loss

**Consolidated statement of financial position**  
**As at 31 December 2019**

	Notes	2019 £'000	2018 £'000
<b>Assets</b>			
<b>Non-current assets</b>			
Intangible assets	9	23,743	17,138
Property, plant and equipment	10	412,658	356,732
Investments	11	75	75
Trade and other receivables	14	232	402
<b>Total non-current assets</b>		<b>436,708</b>	<b>374,347</b>
<b>Current assets</b>			
Inventories	13	22,061	11,261
Other assets	17	—	3,105
Trade and other receivables	14	48,287	30,640
Income tax recoverable		227	292
Cash and cash equivalents	15	50,092	30,027
<b>Total current assets</b>		<b>120,667</b>	<b>75,325</b>
<b>Total assets</b>		<b>557,375</b>	<b>449,672</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables	16	46,796	36,348
Lease liabilities	17	1,013	—
Other liabilities	17	—	3,105
Bank loans and overdrafts	17	1,724	172,016
<b>Total current liabilities</b>		<b>49,533</b>	<b>211,469</b>
<b>Non-current liabilities</b>			
Bank loans	17	267,536	—
Lease liabilities	17	2,950	—
Deferred tax liabilities	20	13,779	12,070
<b>Total non-current liabilities</b>		<b>284,265</b>	<b>12,070</b>
<b>Total liabilities</b>		<b>333,798</b>	<b>223,539</b>
<b>Net assets</b>		<b>223,577</b>	<b>226,133</b>
<b>Equity</b>			
Share capital	22	1,128	1,125
Share premium		160,106	158,861
Other reserve	24	9,562	9,562
Own share reserve	22	(768)	(588)
Foreign currency translation reserve		(66)	—
Retained earnings		53,615	57,173
<b>Total equity attributable to owners of the parent</b>		<b>223,577</b>	<b>226,133</b>

**Consolidated statement of changes in equity**  
**For the year ended 31 December 2019**

	Share capital	Share premium	Other reserve	Own share reserve	Foreign currency translation reserve	Retained earnings	Total
Attributable to the owners of the parent company:	£'000	£'000	£'000	£'000	£'000	£'000	£'000
<b>As at 1 January 2018</b>	1,124	158,592	9,562	(697)	—	58,991	227,572
Total comprehensive income for the year	—	—	—	—	—	4,464	4,464
<b>Transactions with owners in their capacity as owners</b>							
Dividends (note 8)	—	—	—	—	—	(6,143)	(6,143)
Shares issued (note 22)	1	269	—	—	—	—	270
Movement in own shares (note 22)	—	—	—	109	—	(339)	(230)
Share-based payments (note 23)	—	—	—	—	—	1,208	1,208
Income tax effect of share options	—	—	—	—	—	(1,008)	(1,008)
<b>As at 31 December 2018</b>	1,125	158,861	9,562	(588)	—	57,173	226,133
Total profit for the year	—	—	—	—	—	3,997	3,997
Total other comprehensive income for the year	—	—	—	—	(66)	—	(66)
<b>Transactions with owners in their capacity as owners</b>							
Dividends (note 8)	—	—	—	—	—	(7,079)	(7,079)
Shares issued (note 22)	3	1,245	—	—	—	(829)	419
Movement in own shares (note 22)	—	—	—	(180)	—	(169)	(349)
Share-based payments (note 23)	—	—	—	—	—	671	671
Income tax effect of share options	—	—	—	—	—	(149)	(149)
<b>As at 31 December 2019</b>	<b>1,128</b>	<b>160,106</b>	<b>9,562</b>	<b>(768)</b>	<b>(66)</b>	<b>53,615</b>	<b>223,577</b>

See notes 23 and 24 for details of the own share reserve and other reserve.

**Consolidated statement of cash flows**  
**For the year ended 31 December 2019**

	2019 £'000	2018 £'000
<b>Operating activities</b>		
Profit before taxation	5,462	5,351
Finance costs	8,461	4,962
Finance income	(278)	(224)
Exceptional items <sup>1</sup>	6,326	15,426
Depreciation	35,137	21,796
Amortisation of intangibles	1,483	2,597
Share-based payment expense	603	488
Loss on disposal of property, plant and equipment	2,280	1,659
Loss on disposal of intangible assets	421	—
Movement in inventories	(10,049)	4,432
Movement in trade and other receivables	(17,503)	(5,215)
Movement in trade and other payables	9,989	(11,639)
<b>Cash generated from operations</b>	<b>42,332</b>	<b>39,633</b>
Income tax received	56	408
<b>Net cash generated from operations</b>	<b>42,388</b>	<b>40,041</b>
<b>Investing activities</b>		
Payment for acquisition of subsidiary, net of cash acquired	(1,027)	—
Payments to acquire property, plant and equipment	(101,698)	(132,643)
Proceeds on disposal of property, plant and equipment	6,407	4,264
Payments to acquire intangible assets	(6,936)	(5,887)
Finance income received	278	224
<b>Net cash used in investing activities</b>	<b>(102,976)</b>	<b>(134,042)</b>
<b>Financing activities</b>		
New borrowings	270,000	101,627
Borrowings repaid	(172,114)	(117,281)
Principal elements of lease payments	(1,075)	—
Finance costs paid	(9,149)	(4,815)
Net proceeds from share issue	419	270
Purchase of own shares	(349)	(230)
Dividends paid	(7,079)	(6,143)
<b>Net cash generated from/(used in) financing activities</b>	<b>80,653</b>	<b>(26,572)</b>
Net increase/(decrease) in cash and cash equivalents	20,065	(120,573)
Cash and cash equivalents at the beginning of the financial year	30,027	150,600
<b>Cash and cash equivalents at the end of the financial year (note 15)</b>	<b>50,092</b>	<b>30,027</b>

<sup>1</sup> Non-cash exceptional items include a £6,837,000 loss on disposal on our meter portfolio, £68,000 cost relating to deferred remuneration arising on the acquisition of a subsidiary in 2016 settled in shares in April 2019, £751,000 stock write-back for returned SMETS1 meters, £93,000 acceleration of loan arrangement fees in relation to the refinancing of the loan facility and £79,000 for non-recurring impairment charges.

In 2018, non-cash exceptional items included a £7,040,000 loss on disposal on our meter portfolio, £5,612,000 impairment on our meter portfolio, £1,653,000 traditional meters stock write down, £720,000 relating to deferred remuneration arising from the acquisition of a subsidiary in 2016 to be settled in shares, £43,000 for impairment of an investment and £358,000 acceleration of loan arrangement fees in relation to the refinancing of the loan facility.

## Accounting policies

This note provides a list of the significant accounting policies adopted in the preparation of these consolidated financial statements. These policies have been consistently applied to all the years presented, unless otherwise stated. The consolidated financial statements of the Group for the year ended 31 December 2019 were approved and authorised for issue in accordance with a resolution of the Directors on 17 March 2020. Smart Metering Systems plc is a public limited company limited by shares and incorporated in Scotland, with its registered office at 2nd Floor, 48 St. Vincent Street, Glasgow G2 5TS. The Company's ordinary shares are traded on AIM.

### Basis of preparation

The consolidated financial statements have been prepared in accordance with EU-endorsed International Financial Reporting Standards (IFRSs), IFRIC interpretations and the Companies Act 2006 applicable to companies reporting under IFRSs.

The financial statements have been prepared on a historical cost basis, modified by the revaluation of certain financial assets and financial liabilities that have been measured at fair value.

The consolidated financial statements are presented in British Pounds Sterling (£), which is Smart Metering System plc's functional and presentation currency, and all values are rounded to the nearest thousand (£'000) except where otherwise indicated.

The financial information set out above does not constitute the Company's statutory accounts for the years ended 31 December 2019 or 2018 but is derived from those accounts. Statutory accounts for the year ended 31 December 2018 have been delivered to the Registrar of companies and those for 2019 will be delivered in due course. The auditor has reported on both sets of accounts; its reports were unqualified, did not contain an emphasis of matter reference and did not contain statements under section 498 (2) or (3) of the Companies Act 2006.

### Going concern

Management prepares budgets and forecasts on a five-year forward-looking basis. These forecasts cover operational cash flows and investment capital expenditure and are prepared based on management's estimation of installation run rates through the UK smart meter rollout.

On 21 December 2018 a new banking facility was signed, providing the business access to £420m over the next five years. The first drawdown under this new facility was on 3 January 2019, at which point the Group's obligations under the previous £280m facility of £172m were settled. These transactions were settled concurrently on a net cash basis.

Net debt amounted to £219.2m at 31 December 2019 and, at that date, undrawn facilities were £150m. The Group balance sheet shows consolidated net assets of £223.6m (2018: £226.1m) of which £398.7m (2018: £350.4m) relates to meter assets.

Based on the above, the Directors consider it appropriate to continue to prepare the financial statements on a going concern basis.

### Basis of consolidation

The consolidated accounts of the Group include the assets, liabilities and results of the Company and subsidiary undertakings in which Smart Metering Systems plc (SMS) has a controlling interest. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has all of the following: power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee); exposure, or rights, to variable returns from its involvement with the investee; and the ability to use its power over the investee to affect its returns.

The acquisition method of accounting is used to account for business combinations by the Group (refer to note 19).

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

## Foreign currency translation

### **Group companies**

The results and financial position of foreign operations (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing historical rate at the date of that balance sheet;
- non-monetary assets at the date of acquisition are translated at the historical rate and are not subsequently revalued;
- income and expenses for each statement of profit or loss and statement of comprehensive income are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income and accumulated in a separate reserve within equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

### **Transactions and balances**

Foreign currency transactions are translated into the functional currency using the exchange rates at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies at year-end exchange rates, are generally recognised in profit or loss. They are deferred in equity if they relate to qualifying cash flow hedges and qualifying net investment hedges or are attributable to part of the net investment in a foreign operation.

Foreign exchange gains and losses that relate to borrowings are presented in the statement of profit or loss, within finance costs. All other foreign exchange gains and losses are presented in the statement of profit or loss on a net basis within administrative expenses.

### **Use of estimates and judgements**

The Directors are required to make judgements, estimates and assumptions about the carrying amount of assets and liabilities that are not readily apparent from other sources. These estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

### **Critical accounting judgements**

The following are the critical judgements that the Directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements:

- capitalisation of internal installation costs:
  - a significant level of in-house installation of customers' meter assets is carried out by the Group, certain costs of which are capitalised (£39.7m in 2019) and depreciated as part of property, plant and equipment depreciation. Judgement is required by management to ascertain the appropriate categories and proportion of overheads and other expenses that are directly attributable to installation of meter assets. Typically, capitalised costs will include staff costs, and a systematic allocation of any production overheads, deemed to be directly attributable to the process of installing a meter owned by the Group. Other general and administrative overheads, such as sales, marketing and training costs, are expensed directly to profit and loss; and
- presentation of losses on disposal of certain meter assets as exceptional items:
  - as a result of the inherent volatility associated with the smart meter rollout, and removal of traditional meter assets as part of this, management has taken the decision to show losses arising on disposal of these meters, being the net book value less the associated termination income received representing proceeds on disposal, as exceptional administrative expenses. By disclosing these amounts separately, the traditional meter asset portfolio can be better tracked to assist the users of the financial statements. A loss on disposal of traditional meter assets has been recognised as an exceptional cost in the year ended 31 December 2019. The change in accounting policy to reduce the residual value of the traditional meter asset portfolio to nil (see note 10 for further details) was designed to reflect the consumption of economic benefit from installed assets, being the income earned from the provision of the meter. On disposal, the receipt of termination income, recognised as a component of the net gain or loss on the disposal of these meter assets, will vary depending on the energy

supplier and is therefore not within our control. As the receipt of proceeds from disposal is inherently volatile, a loss on disposal can still arise in certain circumstances.

- technical communication issues for some first-generation smart meter assets (SMETS1 meters) on supplier churn have continued through 2019, with the enrolment and adoption process into the DCC delayed into 2020. As a result, the Group has continued to see a very small proportion of SMETS1 meters removed from the wall. As these removals are attributable to the temporary industry transition period, management has taken the judgement to recognise losses arising on the disposal of these meters as exceptional.

### **Key sources of estimation uncertainty**

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that may have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

- recoverability of carrying value of meter assets portfolio:
  - as the smart meter rollout progresses, our portfolio of traditional meter assets is diminishing. It is therefore crucial that the recoverability of the carrying value of our meter assets, recognised in property, plant and equipment, be assessed. The two main drivers for assessing this recoverability are:
    - 1) the timing of the removals of these meters given this decision lies with the end consumer and removals are largely undertaken by third parties. We thus have little control over the timing and quantity of these removals; and
    - 2) the estimated future cash flows from termination income, which are derived using historical data and analysis around the risk of churn between contracted and non-contracted customers. This assessment includes consideration of the extent to which termination income and future rental income are received as traditional meters continue to be removed from the wall.

In 2019, this assessment has identified that the carrying value of the traditional meter assets portfolio is recoverable and, therefore, no impairment charge has been recognised. The carrying value of the traditional meter assets portfolio at 1 January 2019 included an impairment charge of £5.6m, which was recognised in 2018 as an exceptional cost of sales in line with our accounting policy (refer to details in note 10).

### **Revenue recognition**

Refer to details in note 2.

### **Exceptional items and separately disclosed items**

The Group presents as exceptional items on the face of the consolidated statement of comprehensive income those items of income and expense which, because of the material nature or expected infrequency of the events giving rise to them, merit separate presentation to allow shareholders to understand better the elements of financial performance in that year, so as to facilitate comparison with prior periods and to assess better trends in financial performance.

Termination fee income is reported as part of "Other operating income" on the consolidated statement of comprehensive income given the materiality and nature. Any termination fee income arising on the loss of meter assets is reported within administrative expenses as a component of net gain or loss on disposal. Termination fee income does not arise from the principal activities of the Group. Any such gain or loss on disposal relating to traditional meter assets and SMETS1 meter assets is disclosed as an exceptional item.

### **Financial assets**

The Group's financial assets include cash and cash equivalents and trade and other receivables. Investments consist of an immaterial debt investment held at amortised cost.

### **Classification**

The Group classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value, either through other comprehensive income (FVOCI) or through profit or loss (FVPL); and
- those to be measured at amortised cost.

The classification depends on the Group's business model for managing the financial assets and the contractual terms of the cash flows.

For investments in equity instruments that are not held for trading, this will depend on whether the Group has made an irrevocable election at the time of initial recognition to account for the equity investment at FVOCI. The Group reclassifies debt investments when and only when its business model for managing those assets changes.

**Recognition and derecognition**

Financial assets are initially recognised on trade date. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership.

**Measurement**

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at FVPL, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

**Trade and other receivables**

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost. They are generally due for settlement within 30 days and are therefore all classified as current. Due to their short-term nature, carrying value is considered to approximate fair value.

**Cash and cash equivalents**

Refer to accounting policy.

**Impairment**

The Group assesses, on a forward-looking basis, the expected credit losses associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables and accrued income, which include contract assets and billed and unbilled receivables arising from contracts with customers, the Group applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

Trade receivables and accrued income are written off, and derecognised, where there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the customer ceasing trading and entering administration with no expected recovery from the Supplier of Last Resort process, or a failure by the customer to make contractual payments for a period of greater than or equal to 365 days past due. Indicators are assessed on an individual customer basis.

Impairment losses, including the loss allowance, on trade receivables and contract assets are presented within administrative expenses. Impairment losses on accrued termination income are presented within other operating income. Subsequent recoveries of amounts previously written off are credited against the same line item.

Further information about the impairment of trade receivables and accrued income, and the Group's exposure to credit risks, can be found in note 18.

**Financial liabilities**

The Group's financial liabilities include trade and other payables, bank loans and overdrafts.

**Classification**

Financial liabilities are classified as financial liabilities at fair value through profit or loss or loans and borrowings, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

**Recognition**

All financial liabilities are recognised initially at fair value and, in the case of bank loans, net of directly attributable transaction costs.

**Measurement****Trade and other payables and bank overdrafts**

Trade and other payables, and overdrafts, are subsequently measured at amortised cost using the effective interest rate method.

Trade and other payables are presented as current liabilities unless payment is not due within twelve months after the reporting period. Due to their short-term nature, carrying value is considered to approximate fair value.

**Bank loans**

Bank loans are subsequently measured at amortised cost. Interest expense on bank loans is recognised in the consolidated income statement using the effective interest rate method.

Transaction costs on revolving credit facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all the facility will be drawn down. In this case, the fee is deferred within other assets until the



drawdown occurs. Upon drawdown of the first loan, these costs are reclassified from other assets to bank loans and subsequently amortised over the term of the facility.

Borrowings are removed from the balance sheet when the obligation specified in the contract is discharged or cancelled or has expired. The difference between the carrying amount of a financial liability that has been extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred, or liabilities assumed, is recognised in profit or loss as other income or finance costs.

If a facility is modified, then it is assessed whether the modification is significant enough to constitute an extinguishment either qualitatively or quantitatively, where the change in present value of cash flows, including any transaction costs paid, exceeds 10%. If a modification is considered an extinguishment of the initial loan, the new modified loan is recorded at fair value and a gain/loss recognised immediately in the consolidated income statement for the difference between the carrying amount of the old loan and the new loan. Where a modification is not significant enough to be an extinguishment, the cash flows under the modified loan are rediscounted at the original effective interest rate and an immediate gain or loss is recognised accordingly in the consolidated income statement on the date of modification.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

### **Offsetting of financial instruments**

Financial assets and financial liabilities are offset, and the net amount reported in the consolidated statement of financial position, if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

### **Research and development**

Expenditure on pure and applied research activities is recognised in the consolidated statement of comprehensive income as an expense as incurred.

Expenditure on product and system development activities is capitalised if the product or process is technically and commercially feasible and the Group intends and has the technical ability and sufficient resources to complete development; if future economic benefits are probable; and if the Group can measure reliably the expenditure attributable to the intangible asset during its development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads.

Capitalised development expenditure is stated at cost less accumulated amortisation and accumulated impairment losses.

Amortisation is calculated when the asset is available for use, so as to write off its cost, less its estimated residual value, over the useful economic life of that asset as follows:

- |  |                           |
|--|---------------------------|
| •Development of ADM™ units   | 10% on cost straight line |
| •Development of internally generated information technology systems (IT development) | 20% on cost straight line |

Capitalised development expenditure on ADM™ units is disclosed within property, plant and equipment as part of meter assets and amortised over the same useful economic life as that applied to the tangible ADM™ unit.

Capitalised IT development expenditure is disclosed within intangible assets as part of IT development and software. Development and software were previously disclosed separately but have been combined into a single asset class for the year ended 31 December 2019 as all costs capitalised within these categories relate to information technology and, with effect from 1 January 2019, are amortised over the same useful economic life of five years.

### **Intangible assets**

Intangible assets acquired separately from third parties consist of software costs, including licence fees. These are recognised as assets, measured at cost and classified as part of IT development and software.

Internally generated intangible assets relate to IT development and are recognised as part of IT development and software. Refer to further details in the research and development accounting policy above.

Intangible assets acquired as part of a business combination are recognised outside goodwill if the asset is separable or arises from contractual or other legal rights. They are recognised at their fair value at the date of acquisition and are subsequently amortised on a straight line based on the timing of projected cash flows of the contracts over their estimated useful lives.

Following initial recognition, intangible assets are measured at cost at the date of acquisition less any amortisation and any impairment losses. Amortisation costs are included within the administrative expenses disclosed in the consolidated statement of comprehensive income.

Intangible assets are amortised over their useful lives as follows:

- IT development and software 20% on cost straight line

Intangibles recognised upon acquisition:

- Customer contracts 10% on cost straight line
- Trademarks 33% on cost straight line

Useful lives are examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

### **Goodwill**

Goodwill represents the excess of the consideration transferred over the fair value of the identifiable assets and liabilities of the acquiree at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is not amortised but is tested annually for impairment and is carried at cost less accumulated impairment losses. See note 12 for detailed assumptions and methodology. Impairment losses are not subsequently reversed.

Goodwill is allocated to cash-generating units (CGUs) for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The units or groups of units are identified at the lowest level at which goodwill is monitored for internal management purposes, being the operating segments.

Contingent consideration is recorded initially at fair value and classified as equity or a financial liability. Contingent consideration classified as equity is not remeasured, but contingent consideration classified as a financial liability is subsequently remeasured at fair value through profit or loss.

Adjustments to provisional fair values of identifiable assets and liabilities (and to estimates of contingent consideration) arising from additional information, obtained within the measurement period (no more than one year from the acquisition date), about facts and circumstances existing at the acquisition date are adjusted against goodwill. Other adjustments to provisional fair values or changes in contingent consideration are recognised through profit or loss.

### **Impairment**

At each reporting date, the Group reviews the carrying amounts of its property, plant and equipment and intangibles, including goodwill, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the CGU to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have been adjusted.

If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (or CGU) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or CGU) in prior years. A reversal of an impairment loss is recognised as income immediately.

Detailed assumptions used in the annual impairment test for goodwill, with regard to discount, growth and inflation rates, are set out in note 12 to the accounts. Detailed assumptions used in the impairment test for meter assets, namely traditional meter assets, are set out in note 10.

## Property, plant and equipment

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment losses. Such cost includes the cost of replacing part of the property, plant and equipment. When significant parts of property, plant and equipment are required to be replaced in intervals, the Group recognises such parts as individual assets with specific useful lives and depreciation, respectively. Pursuant to the acquisition of the meter installation businesses on 18 March 2016 certain internal costs to the Group are also capitalised where they are demonstrated as being directly attributable to bringing the meter assets into their usable condition.

All other repair and maintenance costs are recognised in the consolidated statement of comprehensive income as incurred.

For each asset depreciation is calculated using the straight line method to allocate its cost, net of its residual value if applicable, over its estimated useful life as follows:

- Freehold property 2%
- Short leasehold property Shorter of the lease term or 15% and 20%
- Meter assets Smart and I&C 5%  
ADM™ units 10%  
Traditional to 31 December 2022
- Plant and machinery 33% on cost
- Motor vehicles 25% on cost
- Right-of-use assets Shorter of the asset's useful life and the lease term

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of comprehensive income when the asset is derecognised. The asset's residual values, useful lives and methods of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate.

Property, plant and equipment is initially recorded at cost.

The following changes in estimates with regard to property, plant and equipment were made with effect from 1 January 2019:

- Subsequent to the impairment review carried out at 31 December 2018, the estimate of residual value on the domestic traditional meter asset portfolio has been reduced to 0% to reflect management's updated forecasts and assumptions regarding the recoverability of value on these assets. As a result, the income statement has been charged with an additional £7.3m, recognised within depreciation in cost of sales.

The following changes in estimates with regards to property, plant and equipment were made with effect from 1 January 2018:

- A review concluded that there should be a change to the I&C electric estimate of useful life from 15 years to 20 years on the basis that these meters are no longer subject to a certification period and fall under the same considerations as smart meters. The impact on the financial statements for the year to 31 December 2018 was a decrease to the depreciation charge in the consolidated income statement and statement of comprehensive income of £266,000.
- The I&C gas portfolio saw the estimate of residual value reduce to 0% to reflect revised customer terms in new customer contracts. As a result, the income statement for the year to 31 December 2018 was charged with an additional £340,000 recognised within depreciation in cost of sales.
- With respect to the domestic traditional meter asset portfolio, the useful life of all opening assets was extended to 5 years to reflect the fact that the expected end date for the domestic smart meter rollout is likely to be at the end of 2022. It is accepted that the rate of meter exchange to smart meters will vary year by year as the rollout proceeds but there is currently no reliable basis on which to predict the annual profile. Accordingly, a straight line approach to depreciation of these assets continues to be adopted. The impact on the financial statements for the year to 31 December 2018 was a decrease to the depreciation charge in the consolidated income statement and statement of comprehensive income of £2.9m.

See note 29 for further details on the recognition and measurement of right-of-use assets under IFRS 16.

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and purchases of meter assets at cost. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

**Cash and cash equivalents**

Cash and cash equivalents in the consolidated statement of financial position comprises cash at bank and in hand and short-term deposits with an original maturity of three months or less. For the purpose of the consolidated statement of cash flows, cash and cash equivalents consists of cash and short-term deposits as defined above, net of outstanding bank overdrafts.

**Leased assets and obligations as lessee*****With effect from 1 January 2019***

As of 1 January 2019, SMS adopted IFRS 16 Leases. Refer to details in note 29.

***Up to 31 December 2018***

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Assets acquired under finance leases are capitalised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is recorded in the balance sheet as a finance lease obligation. The lease payments are apportioned between finance charges to the income statement and a reduction of the lease obligations.

Rental payments under operating leases are charged to the income statement on a straight line basis over the applicable lease periods.

**Group as lessor*****With effect from 1 January 2019***

As of 1 January 2019, SMS adopted IFRS 16 Leases. Refer to details in note 29.

***Up to 31 December 2018***

Leases in which the Group does not transfer substantially all the risks and rewards of ownership of assets are classified as operating leases with meter income recognised in line with the meter rental income policy.

**Pension costs**

The Group operates a defined contribution pension scheme for employees. The assets of the scheme are held separately from those of the Group. The annual contributions payable are charged to the consolidated statement of comprehensive income.

**Share-based payments**

IFRS 2 Share-based Payment has been applied to all grants of equity instruments. The Group issues equity-settled share-based payments to certain employees under the terms of the Group's various employee share and option schemes. Equity-settled share-based payments are measured at fair value at the date of the grant. The fair value determined at the grant date of equity-settled share-based payments is expensed on a straight line basis over the vesting period, based on an estimate of the shares that will ultimately vest.

**Share capital**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction from the proceeds.

**Own share reserve**

The Group offers a Share Incentive Plan for all employees and has established a trust to facilitate the delivery of SMS shares under this plan. The holdings of this trust include shares that have not vested unconditionally to employees of the Group. These shares are recorded at cost and are classified as own shares. The cost to the Company of acquiring these own shares held in trust is shown as a deduction from shareholders' equity.

**Dividends**

Dividend distributions to the Company's shareholders are recognised in the accounting period in which the dividends are paid.

## Taxation

Tax currently payable is based on the taxable profit for the year and any adjustment to tax payable in respect of prior years. Taxable profit differs from accounting profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is measured using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred tax is the tax expected to be payable or recoverable on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax is recognised in respect of all temporary differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date.

Deferred tax is measured at the tax rates that are expected to apply in the periods in which the asset or liability is settled based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. It is recognised in the income statement except when it relates to items recognised in other comprehensive income or directly in equity, such as share-based payments. In this case, the deferred tax is also recognised in other comprehensive income or directly in equity, respectively.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary difference can be utilised. Their carrying amount is reviewed at each balance sheet date on the same basis.

Deferred tax liabilities are recognised for all temporary differences, except in respect of:

- temporary differences arising from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss; and
- temporary differences associated with investments in subsidiaries where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

## Standards and interpretations

### *New and amended standards adopted by the Group*

The Group has applied the following standards and amendments for the first time for their annual reporting period commencing 1 January 2019:

Standard or interpretation		Effective date
IFRS 16	Leases	1 January 2019
Various	Annual Improvements to IFRSs – 2015–2017 Cycle	1 January 2019
IFRIC 23	Uncertainty over Income Tax Treatments	1 January 2019

The Group had to change its accounting policies as a result of adopting IFRS 16. See further details in note 29. The other amendments listed above did not have any impact on the amounts recognised in prior periods and the current period and are not expected to significantly affect future periods. The Group does not currently have any material uncertain tax positions.

The following new accounting standards and interpretations have been published that are not mandatory for 31 December 2019 reporting periods and have not been early adopted by the Group. These standards are not expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions:

Standard or interpretation		Effective date
IFRS 3 (amendment)	Definition of a Business	1 January 2020
IAS 1 and IAS 8 (amendment)	Definition of Material	1 January 2020
CF	Conceptual Framework for Financial Reporting	1 January 2020

## Notes to the financial statements

### For the year ended 31 December 2019

#### 1 Segmental reporting

For management purposes, the Group is organised into three core divisions, as follows:

- asset management, which comprises regulated management of gas meters, electric meters and ADM™ units within the UK;
- asset installation, which comprises installation of domestic and I&C gas meters and electricity meters throughout the UK; and
- energy management, which comprises the provision of energy consultancy services and, following the acquisition of Solo Energy Limited, the management of Distributed Energy Resources (DER) assets.

The Group's chief operating decision maker (CODM), being the SMS plc Board, receives certain management information at a granular "utility" level. Asset management includes reporting on gas meter rental, electricity meter rental, gas data and electricity data. Asset installation includes reporting on gas transactional work and electricity transactional work. However, whilst the Group has the ability to analyse its underlying information in this way, this information is only used to assess performance for the Group as a whole. These utility levels are thus combined within asset management and asset installation, respectively, on the basis that they have similar long-term economic characteristics – they derive from the same asset, use similar delivery processes, have consistent customers and have similar long-term gross margins.

For the purpose of making decisions about resource allocation and performance assessment, it is the operating results of the three core divisions listed above that are monitored by management and the CODM. It is these divisions, therefore, that are defined as the Group's reportable operating segments.

Segment performance is evaluated based on gross profit.

The following segment information is presented in respect of the Group's reportable segments together with additional balance sheet information:

	Asset management	Asset installation	Energy management	Unallocated	Total operations
31 December 2019	£'000	£'000	£'000	£'000	£'000
<b>Segment revenue</b>	<b>82,907</b>	<b>59,968</b>	<b>9,024</b>	<b>—</b>	<b>151,899</b>
Inter-segment revenue	—	(37,618)	—	—	(37,618)
<b>Revenue from external customers</b>	<b>82,907</b>	<b>22,350</b>	<b>9,024</b>	<b>—</b>	<b>114,281</b>
Cost of sales	(37,389)	(27,981)	(6,847)	—	(72,217)
<b>Segment gross profit</b>	<b>45,518</b>	<b>(5,631)</b>	<b>2,177</b>	<b>—</b>	<b>42,064</b>
Other operating costs/income	—	—	—	(14,659)	(14,659)
Depreciation	(1,347)	—	—	(2,299)	(3,646)
Amortisation of intangibles	(1,473)	—	(10)	—	(1,483)
Exceptional items	(8,085)	(51)	—	(391)	(8,527)
<b>Profit from operations</b>	<b>34,613</b>	<b>(5,682)</b>	<b>2,167</b>	<b>(17,349)</b>	<b>13,749</b>
Net finance costs: exceptional	(104)	—	—	—	(104)
Net finance costs: other	(8,065)	—	—	(118)	(8,183)
<b>Profit before tax</b>	<b>26,444</b>	<b>(5,682)</b>	<b>2,167</b>	<b>(17,467)</b>	<b>5,462</b>
Tax expense	—	—	—	—	(1,465)
<b>Profit for year</b>					<b>3,997</b>

31 December 2018	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
<b>Segment revenue</b>	65,468	52,153	6,469	—	124,090
Inter-segment revenue	—	(25,598)	—	—	(25,598)
<b>Revenue from external customers</b>	65,468	26,555	6,469	—	98,492
Cost of sales	(25,746)	(20,500)	(5,087)	—	(51,333)
<b>Segment gross profit</b>	39,722	6,055	1,382	—	47,159
Other operating costs/income	—	—	—	(15,930)	(15,930)
Depreciation	—	(280)	—	(1,126)	(1,406)
Amortisation of intangibles	(2,597)	—	—	—	(2,597)
Exceptional items	(12,652)	(1,653)	—	(1,836)	(16,141)
<b>Profit from operations</b>	24,473	4,122	1,382	(18,892)	11,085
Net finance costs: exceptional	(996)	—	—	—	(996)
Net finance costs: other	(4,738)	—	—	—	(4,738)
<b>Profit before tax</b>	18,739	4,122	1,382	(18,892)	5,351
Tax expense	—	—	—	—	(887)
<b>Profit for year</b>					4,464

Inter-segment revenue relates to installation services provided by the asset installation segment to the asset management segment.

Depreciation of £31.5m (2018: £20.4m) associated with meter assets has been reported within cost of sales, in the asset management segment, as the meter assets directly drive revenue.

All revenues and operations are based and generated in the UK.

The Group has one major customer that generated turnover within each segment as listed below:

	2019 £'000	2018 £'000
Customer 1 – asset management	14,030	6,024
Customer 1 – asset installation	796	1,753
	<b>14,826</b>	<b>7,777</b>

#### **Segment assets and liabilities**

31 December 2019	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
<b>Assets reported by segment</b>					
Intangible assets	18,417	3,493	1,833	—	23,743
Property, plant and equipment	403,948	518	—	8,192	412,658
Inventories	21,734	327	—	—	22,061
Contract assets	—	11	—	—	11
	<b>444,099</b>	<b>4,349</b>	<b>1,833</b>	<b>8,192</b>	<b>458,473</b>
<b>Assets not by segment</b>					<b>98,902</b>
<b>Total assets</b>					<b>557,375</b>
<b>Liabilities by segment</b>					
Contract liabilities	1,360	2,010	124	—	3,494
Lease liabilities	893	—	—	3,072	3,965
Bank loans	269,260	—	—	—	269,260
	<b>271,513</b>	<b>2,010</b>	<b>124</b>	<b>3,072</b>	<b>276,719</b>
<b>Liabilities not by segment</b>					<b>57,079</b>
<b>Total liabilities</b>					<b>333,798</b>

31 December 2018	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
<b>Assets reported by segment</b>					
Intangible assets	13,643	3,495	—	—	17,138
Property, plant and equipment	350,360	2,463	—	3,909	356,732
Inventories	10,762	499	—	—	11,261
Contract assets	2	20	—	—	22
	374,767	6,477	—	3,909	385,153
<b>Assets not by segment</b>					64,519
<b>Total assets</b>					449,672
<b>Liabilities by segment</b>					
Contract liabilities	1,010	1,801	418	—	3,229
Bank loans	172,016	—	—	—	172,016
	173,026	1,801	418	—	175,245
<b>Liabilities not by segment</b>					48,294
<b>Total liabilities</b>					223,539

Assets not by segment include cash and cash equivalents, trade and other receivables and investments. In 2018, assets not by segment included cash and cash equivalents, trade and other receivables, other assets and investments.

Liabilities not by segment include trade and other payables and deferred tax liabilities. In 2018, liabilities not by segment included trade and other payables, other liabilities and deferred tax liabilities.

Additions to non-current assets within each segment are listed below:

	Asset management £'000	Asset installation £'000	Energy management £'000	Unallocated £'000	Total operations £'000
<b>Additions to non-current assets</b>					
<b>2019</b>	<b>106,452</b>	<b>509</b>	<b>67</b>	<b>6,495</b>	<b>113,523</b>
2018	134,882	2,685	—	963	138,530

## 2 Revenue from contracts with customers

### 2 (a) Disaggregation of revenue from contracts with customers

The Group reports the following segments: asset management, asset installation and energy management, in accordance with IFRS 8 Operating Segments. We have determined that, to meet the objective of the disaggregation disclosure requirement in paragraph 114 of IFRS 15, which is to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors, further disaggregation is required into the major types of services offered. The following table thus discloses segmental revenue by type of service delivered and timing of revenue recognition, including a reconciliation of how this disaggregated revenue ties in with the asset management, asset installation and energy management segments, in accordance with paragraph 115 of IFRS 15.

Year ended 31 December 2019	Asset management £'000	Asset installation £'000	Energy management £'000	Total operations £'000
<b>Major service lines</b>				
Metering	75,472	—	—	75,472
Data management	7,435	—	—	7,435
Utility connections	—	8,406	—	8,406
Transactional meter works	—	13,295	—	13,295
Energy management	—	649	9,024	9,673
	82,907	22,350	9,024	114,281
<b>Timing of revenue recognition</b>				
Services transferred at a point in time	—	13,172	—	13,172
Services transferred over time	82,907	9,178	9,024	101,109
	82,907	22,350	9,024	114,281



Year ended 31 December 2018	Asset management £'000	Asset installation £'000	Energy management £'000	Total operations £'000
<b>Major service lines</b>				
Metering <sup>1</sup>	58,507	—	—	58,507
Data management	6,961	—	—	6,961
Utility connections	—	9,687	—	9,687
Transactional meter works	—	16,290	—	16,290
Energy management	—	578	6,469	7,047
	65,468	26,555	6,469	98,492
<b>Timing of revenue recognition</b>				
Services transferred at a point in time	—	14,677	—	14,677
Services transferred over time	65,468	11,878	6,469	83,815
	65,468	26,555	6,469	98,492

1 The "Metering" service line within asset management includes operating lease rental income recognised under IAS 17. Approximately 86% of the revenue recognised of £58,507,000 in 2018 relates to operating lease income. See note 29 for further details on the Group's lessor accounting under IFRS 16, effective 1 January 2019.

## 2 (b) Assets and liabilities related to contracts with customers

The Group has recognised the following assets and liabilities related to contracts with customers:

	2019 £'000	2018 £'000
Current contract assets	11	22
<b>Total contract assets</b>	<b>11</b>	<b>22</b>
Current contract liabilities	3,494	3,229
<b>Total contract liabilities</b>	<b>3,494</b>	<b>3,229</b>

Trade receivables and unbilled receivables are disclosed in note 14.

### (i) Significant changes in contract assets and liabilities

Contract assets and contract liabilities have not changed significantly and movements reflect the general timing of revenue recognition and status of services in progress at the end of the year.

### (ii) Revenue recognised in relation to contract liabilities

The following table shows how much of the revenue recognised in the current period relates to carried-forward contract liabilities:

	2019 £'000	2018 £'000
Revenue recognised that was included in the contract liability balance at the beginning of the period	3,057	3,139

No revenue was recognised in 2019 in relation to performance obligations satisfied in previous periods.

### (iii) Transaction price for which performance obligations not satisfied

All our utilities connections and energy management contracts are either for periods of one year or less or are billed periodically based on time and resources incurred, or other unit measures. As permitted under IFRS 15, the transaction price allocated to these performance obligations unsatisfied at the end of the reporting period is not disclosed.

## 2 (c) Accounting policies and significant judgements

### (i) Metering

#### Meter rental

The Group acts as a gas and electricity meter asset provider, providing and installing meters to energy suppliers on behalf of the end consumer.

#### With effect from 1 January 2019

As a result of the Group's assessment of contracts on implementation of IFRS 16, and any potential interaction with IFRS 15, the arrangements the Group has in place to act as meter asset provider were reconsidered and it was determined that the contract does not constitute a lease of the meter asset to the energy supplier. See note 29 for

further details. With effect from 1 January 2019, therefore, the related income for the service of providing a fitted meter is recognised in accordance with IFRS 15.

The provision of meter assets to energy suppliers (MAP services), together with the initial installation, is considered a distinct and single performance obligation on the basis that, as Meter Asset Provider (MAP), the Group has an obligation to its customers to provide a fitted meter. This is a separately identifiable service to which a stand-alone selling price is typically allocated. Over the course of the contract term, which runs into perpetuity, the Group delivers a series of monthly services for which benefits are simultaneously received and consumed by the customer.

MAP charges are calculated daily based on the number of installed meters and invoiced to customers monthly once validation checks have been completed. As revenue from MAP charges is attributed to services provided daily, revenue is always based on the actual level of service provided and, therefore, any uncertainty at the end of each reporting period is limited to the extent that validation checks are still being completed. Revenue is thus recognised over time based on our right to invoice and includes contract RPI uplifts.

As a result of industry regulations, and subject to specific contract terms with a customer, the Group may be required to make payments to customers for shortfalls in the level of service provided. These charges are directly related to the service being provided to the customer and thus recognised as a reduction to revenue in the month in which the service failure occurred. Where service levels are set based on annual targets, charges are estimated monthly and subsequently finalised at the end of the year. Uncertainty, as it pertains to these payments to customers, is thus typically resolved by the end of the reporting period.

If a MAP contract is cancelled, termination fees may be levied on the energy supplier. There has been no change in the accounting of these termination fees and they continue to be classified within other operating income unless they have arisen on the loss of the meter assets, in which case they are reported within administrative expenses as a component of net gain or loss on disposal.

If the services rendered by the Group exceed the payment received, then accrued income is recognised. This is subsequently reclassified to receivables at the point at which the Group has an unconditional right to payment.

#### ***Up to 31 December 2018***

The provision of the meter asset is accounted for as an operating lease under IAS 17 on the basis that the energy suppliers have control of the data being collected from the meter over the duration of the contract. Meter rentals receivable from energy suppliers are accounted for as operating lease payments and recognised as rental income under IAS 17. This income is calculated daily, based on the number of meter assets, and invoiced to customers monthly. Rental contracts do not operate on a fixed-term basis and are cancellable at any time by the lessee.

The installation of the meter is considered integral to the use of the underlying asset and therefore is accounted for as part of the lease of the meter. Consideration for installation is recognised as part of the total consideration earned from meter rentals.

If a rental contract is cancelled termination payments may be levied on the energy supplier. In line with the underlying contractual terms, termination fees due are recognised at fair value upon notification of de-appointment and are classified as other operating income unless the fees have arisen on the loss of meter assets, in which case they are reported within administrative expenses as a component of net gain or loss on disposal.

If the services rendered by the Group exceed the payment received, then accrued income is recognised. This is subsequently reclassified to receivables at the point at which the Group has an unconditional right to payment.

#### **Asset management services**

The Group provides meter asset management and operations services to energy suppliers. These services are considered a distinct performance obligation from the meter rental on the basis that these are separately identifiable services to which a stand-alone selling price is allocated, and they are not necessary to bring the meter asset into use.

Over the course of the contract term, which can either be fixed or into perpetuity, the Group delivers a series of monthly services for which the benefits are simultaneously received and consumed by a customer. Therefore, these are accounted for as a single performance obligation.

Service charges are calculated daily based on the number of meters appointed and invoiced to customers monthly. As revenue from service charges is attributed to services provided daily, revenue is always based on the actual level of service provided and, therefore, there is no uncertainty at the end of each reporting period. Revenue is thus recognised over time based on our right to invoice and includes contract RPI uplifts.

The Group's meter asset management contracts also include the provision of transactional meter works. These are considered further in accounting policy (iv) below.

If the services rendered by the Group exceed the payment received, then a contract asset is recognised. This is subsequently reclassified to receivables at the point at which the Group has an unconditional right to payment.

*(ii) Data services*

The Group provides data collection and aggregation services to I&C electricity customers and, through use of the ADM™ unit, to I&C gas customers. Over the course of the contract term, which can either be fixed or into perpetuity, the Group delivers a series of monthly services for which the benefits are simultaneously received and consumed by a customer. Therefore, these are accounted for as a single performance obligation.

Service charges are calculated based on the number of meters/ADM™ units appointed and invoiced to customers monthly. As revenue from service charges is attributed to services provided periodically, revenue is always based on the actual level of service provided and, therefore, there is no uncertainty at the end of each reporting period. Service charges, including contract RPI uplifts, are billed to clients annually in advance and therefore a contract liability is recognised and subsequently released to the income statement over the year on a straight line basis. The Group uses the practical expedient under IFRS 15 from adjusting revenue for any significant financial components of one year or less.

The ADM™ device is a proprietary product for the Group and there are no other market providers of this device. A customer cannot therefore benefit from the data services without installation, and the installation is not separately identifiable as it is integral to the subsequent data services. This is therefore accounted for along with the data services as a single performance obligation and any corresponding charges are recognised over the term of the contract.

*(iii) Utility connections services (gas and electricity)*

Gas and electricity connections services are provided under fixed-price contracts with I&C customers and can be delivered to a single site or multiple sites. Whilst each service consists of multiple activities, the Group's promise in the contract is to deliver an integrated end-to-end service to which the underlying activities are inputs. Where services are delivered to multiple sites, and these are substantially the same, a series of services is being provided. In all cases, therefore, these contracts give rise to a single performance obligation to which the fixed price is allocated. Subsequent variations to this price, due to changes in the inputs required, are accounted for as contract modifications and recognised on a cumulative catch-up basis.

Services are transferred over time on the basis that these are customised services with no alternative use and the Group has an enforceable right to payment for work completed to date.

Revenue is recognised on the stage of completion with reference to the actual services provided as a proportion of the total service expected to be provided under the contract as the services can enhance a work in progress asset for the customer and have no alternative use. This is determined on a contract by contract basis using a milestone approach with reference to the milestones set out in the contract or otherwise agreed. Where relevant, consideration is also given to material services provided between milestones. Estimates of revenues, costs or extent of progress towards completion are revised if circumstances change and any resulting increases or decreases in estimated revenues or costs are reflected in profit or loss in the period in which the circumstances that give rise to the revision become known by management.

The customer pays the fixed amount based on a payment schedule. In certain circumstances the customer pays in advance and therefore a contract liability is recognised and subsequently released to the income statement based on the measure of progress detailed above. As the contract is cancellable at the customer's discretion, subject to settlement for services provided to the date of cancellation, a contract liability is not recognised until the cash has been received.

If the services rendered by the Group exceed the payment received, then a contract asset is recognised. This is subsequently reclassified to receivables at the point at which the Group has an unconditional right to payment.

The Group utilises the practical expedient available under IFRS 15 for costs to obtain a contract. Commissions paid as part of obtaining a contract are expensed as incurred on the basis that the contract term is typically less than twelve months.

*(iv) Transactional meter works*

Transactional works, which include emergency, adversarial and other maintenance services, and are typically short term in nature, are accounted for as a separate performance obligation to asset management services (see section (i) above) on the basis that these are separately identifiable and can be performed by another party. A customer, being the energy supplier, is legally obligated to appoint a meter asset manager and can therefore benefit from this service

in isolation, without the subsequent transactional works which are initiated on an ad-hoc basis upon demand by the customer.

Transactional meter works also include contracts with customers for installation-only services.

The transaction price allocated to transactional works is based on stand-alone selling prices (per unit, where relevant) and revenue is recognised at a point in time when the transaction has been completed and accepted by the customer. This is the point at which the customer is charged for the service and a receivable is recognised by the Group as we have an unconditional right to payment. The customer will settle the transaction price for these services as part of the regular monthly billing cycle for metering services.

The customer pays the fixed amount based on the transactional services provided and this is charged once the service has been completed and accepted by the customer.

For segmental purposes, this transactional, non-recurring revenue is recognised within asset installation.

#### *(v) Energy management services*

Energy management services provided mainly to I&C customers include utility bureau and bill validation services, risk management and procurement services and energy reduction and environmental management services.

Certain services, such as utility bureau and bill validation, are delivered through a series of monthly services over the course of the contract term, for which the benefits are simultaneously received and consumed by a customer. These are accounted for as a single performance obligation. The transaction price allocated includes a fixed monthly service charge together with a variable component for specific activities that may not be carried out every month. As revenue from charges is attributed to services provided monthly, revenue is always based on the actual level of service provided and, therefore, there is no uncertainty at the end of each reporting period. Revenue is thus recognised over time based on our right to invoice.

Contracts for specialist consultancy services may include multiple projects. Where these projects are separately identifiable within the contract and are not interrelated, they are accounted for as separate performance obligations. The transaction price is allocated based on the stand-alone charges for each project.

Other energy reduction and environmental management services are typically longer-term, multi-site contracts and, therefore, the revenue recognition is consistent with that detailed above for utility connections – see details in note 2 (c)(iii) above.

#### *(vi) Assets and liabilities arising from contracts with customers*

##### **Costs to fulfil a contract**

In certain circumstances, the Group may incur costs to fulfil its obligations under a contract once it is obtained, but before transferring goods or services to the customer. These costs are assessed on a contract by contract basis and, where they are considered to meet the definition of fulfilment costs under IFRS 15, they are recognised as an asset and amortised on a systematic basis consistent with the pattern of transfer of the services to which the asset relates.

##### **Contract assets and liabilities**

We receive payments from customers based on a billing schedule, as established in our contracts.

The timing of revenue recognition, billing and cash collections results in:

- billed and unbilled accounts receivable, which are recognised when our right to consideration becomes unconditional, and classified as trade receivables and accrued income respectively;
- unbilled amounts, where we have a conditional right to consideration based on future performance, recognised as contract assets. These amounts will be billed in accordance with the agreed upon contractual terms; and
- payments received in advance of performance under a contract, recognised as contract liabilities. Contract liabilities are recognised as revenue as (or when) we perform under a contract.

For project-based services, work in progress is billed in accordance with the agreed upon contractual terms with the customer. We typically receive interim payments as work progresses, which can give rise to a billed or unbilled accounts receivable, where our right to payment is unconditional, or a contract asset, where revenue has been recognised based on progress completed but our right to payment is still conditional on future performance. For some contracts, we may be entitled to receive advance payments. We recognise a contract liability for these advance payments in excess of revenue recognised.

Cancellation terms can vary but typically include provisions that allow the customer to terminate the contract at their discretion subject to a penalty or settlement of amounts for work completed prior to termination. Contracts allow both parties to cancel without penalty in the case of a material breach of contract.

### 3 Profit from operations

The Group has identified a number of items which are material due to the significance of their nature and/or amount. These are listed separately here to provide a better understanding of the financial performance of the Group.

	2019 £'000	2018 £'000
<b>Profit from operations is stated after (charging)/crediting:</b>		
<b>Cost of sales:</b>		
Direct subcontractor costs	(7,195)	(6,786)
Depreciation of meter assets	(31,491)	(20,390)
Direct staff and other costs	(31,212)	(22,335)
Inventory costs	(2,319)	(1,822)
<b>Total cost of sales (before exceptional items)</b>	<b>(72,217)</b>	<b>(51,333)</b>
<b>Administrative expenses:</b>		
Staff costs	(12,380)	(11,447)
Depreciation:		
– owned assets	(2,729)	(1,406)
– leased assets	(917)	—
Amortisation of intangibles	(1,483)	(2,597)
Auditor's remuneration (note 3a)	(300)	(191)
Loss on disposal	(2,701)	(1,659)
Operating lease rentals <sup>1</sup>	(1,032)	(2,041)
Research and development costs	—	(307)
Other operating charges	(3,972)	(1,615)
<b>Total administrative expenses (before exceptional items)</b>	<b>(25,514)</b>	<b>(21,263)</b>
Exceptional items (note 3b)	(8,527)	(16,141)
Other operating income (note 3c)	5,726	1,330
<b>Total operating costs</b>	<b>(100,532)</b>	<b>(87,407)</b>

1 2019 operating lease rentals include £1,010,000 on short-term leases and £22,000 on leases of low value assets.

#### 3 (a) Auditor's remuneration

Auditor's remuneration can be analysed as:

	2019 £'000	2018 £'000
Audit of the parent company and consolidated financial statements	95	55
Audit of the financial statements of the Company's subsidiaries	155	107
Other services – audit related assurance services	50	29
	<b>300</b>	<b>191</b>

#### 3 (b) Exceptional items

There are total exceptional items on the consolidated income statement of £8,631,000.

Exceptional operating costs comprise £6,837,000 for losses on disposal of our meter portfolio (£11,819,000 net book value less £4,982,000 termination income), £1,999,000 of legal and professional fees incurred as part of the conditional sale of a minority of our assets, £751,000 SMETS1 meters stock write-back, £96,000 of redundancy costs relating to the reorganisation of subsidiaries, £92,000 of costs incurred in relation to the acquisition of Solo Energy Limited, £82,000 of costs that the Company has agreed to settle in relation to a former legacy Employee Benefit Trust, £68,000 of deferred remuneration arising on the acquisition of a subsidiary in 2016 settled in shares in April 2019 and £104,000 impairment charges.

Exceptional finance costs of £104,000 include £98,000 accelerated amortisation of loan arrangement fees in relation to the refinancing of the loan facility and £6,000 of bank break fees.

In 2018, there are total exceptional items on the consolidated income statement of £17,137,000. Exceptional operating costs comprise £12,652,000 for losses on our meter portfolio (including an impairment charge of £5,612,000), £1,653,000 traditional meters stock write down, £720,000 of deferred remuneration arising on the acquisition of a subsidiary in 2016 to be settled in shares, £810,000 of costs that the Company has agreed to settle in relation to a former legacy Employee Benefit Trust, £198,000 of redundancy costs relating to the reorganisation of subsidiaries and £108,000 impairment of subsidiary undertaking SMS Italia SRL, together with associated costs.

Exceptional finance costs of £996,000 include £358,000 accelerated amortisation of bank loan fees and £635,000 legal and professional fees incurred in conjunction with the refinancing of the loan facility and £3,000 of bank break fees.

The tax effect of exceptional items charged in 2019 is a credit of £1,119,000 (2018: £2,948,000).

### 3 (c) Other operating income

In 2019, other operating income represents termination fee income and non-recurring, contractual charges.

In 2018, other operating income represents termination fee income only.

### 4 Particulars of employees

The average number of staff employed by the Group during the financial year, including Executive Directors, by activity was:

	2019 Number	2018 Number
Administrative staff	487	263
Operational staff	669	602
Sales staff	4	3
IT staff	62	45
Directors (excluding 4 (2018: 3) Non-executive Directors)	3	2
	<b>1,225</b>	<b>915</b>

The aggregate payroll costs, including Executive Directors, of the employees were:

	2019 £'000	2018 £'000
Wages and salaries	39,817	29,993
Social security costs	4,400	3,047
Staff pension costs	1,115	638
Share-based payment (note 23)	671	1,208
Director pension costs	11	8
	<b>46,014</b>	<b>34,894</b>

### 5 Finance costs and finance income

	2019 £'000	2018 £'000
<b>Finance costs</b>		
Bank loans and overdrafts	8,255	4,962
Lease liabilities	157	—
Foreign exchange loss on intragroup borrowings	49	—
Total pre-exceptional finance costs	8,461	4,962
Exceptional finance costs	104	996
Total finance costs	<b>8,565</b>	<b>5,958</b>
<b>Finance income</b>		
Bank interest receivable	278	224
Total finance income	<b>278</b>	<b>224</b>

### 6 Taxation

	2019 £'000	2018 £'000
<b>Analysis of charge in the year</b>		
Current tax:		
Current income tax expense	(81)	(127)
Adjustment to tax charge in respect of previous periods	2	(37)
Total current income tax	(79)	(164)
Deferred tax:		
Origination and reversal of temporary differences	1,405	1,056
Adjustment to tax charge in respect of prior periods	139	(5)
Tax on profit	<b>1,465</b>	<b>887</b>

The charge for the period can be reconciled to the profit per the consolidated statement of comprehensive income as follows:

<b>Profit before tax</b>	<b>5,642</b>	5,351
Tax at the UK corporation tax rate of 19.00% (2018: 19.00%)	<b>1,038</b>	1,017
Expenses not deductible for tax purposes	<b>420</b>	40
Deferred tax not recognised	<b>—</b>	—
Adjustments to tax charge in respect of previous periods	<b>142</b>	(43)
Change in tax rate	<b>(135)</b>	(127)
<b>Tax expense in the income statement</b>	<b>1,465</b>	887

Current tax credit through equity in the year was £Nil (2018: £85,000).

## 7 Earnings per share (EPS)

The calculation of EPS is based on the following data and number of shares:

	<b>2019</b>	2018
	<b>£'000</b>	£'000
Profit for the year used for calculation of basic EPS	<b>3,997</b>	4,464
Number of shares	<b>2019</b>	2018
Weighted average number of ordinary shares for the purposes of basic EPS	<b>112,446,154</b>	112,408,338
Effect of potentially dilutive ordinary shares:		
– share options	<b>823,258</b>	1,056,897
Weighted average number of ordinary shares for the purposes of diluted EPS	<b>113,269,412</b>	113,465,235
EPS:		
– basic (pence)	<b>3.56</b>	3.97
– diluted (pence)	<b>3.53</b>	3.93

## 8 Dividends

	Year ended 31 December 2019 £'000	Year ended 31 December 2019 Per share (pence)	Year ended 31 December 2018 £'000	Year ended 31 December 2018 Per share (pence)
Paid final dividend	<b>4,485</b>	<b>3.98</b>	3,892	3.46
Paid interim dividend	<b>2,594</b>	<b>2.30</b>	2,251	2.00
<b>Total dividends</b>	<b>7,079</b>	<b>6.28</b>	6,143	5.46

A final cash dividend for 2019 of 4.58p per share (2018: 3.98p) has been declared by the Directors and will be paid in June 2020. These dividends amount to c.£5,162,000 and will be accounted for in 2020. Including the interim dividend for 2019 of 2.30p per share (2018: 2.00p), this gives a full-year dividend for 2019 of 6.88p per share (2018: 5.98p).

As at 31 December 2019 the distributable profits in the parent company were adequate to cover the proposed final dividend of c.£5,162,000.

## 9 Intangible assets

	Goodwill £'000	Intangibles recognised upon acquisition £'000	IT development and software <sup>1</sup> £'000	Total £'000
<b>Cost</b>				
As at 1 January 2018	7,609	2,166	11,813	21,588
Additions	—	—	5,887	5,887
Disposals	—	—	(22)	(22)
As at 31 December 2018	7,609	2,166	17,678	27,453
Additions	—	—	6,936	6,936
Acquisitions	995	96	697	1,788
Reclassifications <sup>2</sup>	—	—	(205)	(205)
Disposals	—	—	(639)	(639)
Exchange adjustments	(57)	(5)	(22)	(84)
<b>As at 31 December 2019</b>	<b>8,547</b>	<b>2,257</b>	<b>24,445</b>	<b>35,249</b>
<b>Amortisation</b>				
As at 1 January 2018	—	1,601	6,117	7,718
Charge for year	—	433	2,164	2,597
As at 31 December 2018	—	2,034	8,281	10,315
Reclassifications <sup>2</sup>	—	—	(74)	(74)
Disposals	—	—	(218)	(218)
Charge for year	—	137	1,346	1,483
<b>As at 31 December 2019</b>	<b>—</b>	<b>2,171</b>	<b>9,335</b>	<b>11,506</b>
<b>Net book value</b>				
<b>As at 31 December 2019</b>	<b>8,547</b>	<b>86</b>	<b>15,110</b>	<b>23,743</b>
As at 31 December 2018	7,609	132	9,397	17,138
As at 1 January 2018	7,609	565	5,696	13,870

1 In the 2018 financial statements development and software were disclosed separately. These have been combined into a single asset class, IT development and software, for the year ended 31 December 2019 as all costs capitalised within these categories relate to IT and, with effect from 1 January 2019, are amortised over the same useful economic life.

2 Capitalised development expenditure on ADM™ units has been reallocated from IT development and software in intangible assets to meter assets within property, plant and equipment, to align with the Group's accounting policy.

The acquisition of Solo Energy Limited in September 2019 resulted in the recognition of goodwill of £995,000, which has been assigned to the energy management operating segment. In addition, the trademarks of Solo Energy Limited and its FlexiGrid platform were valued at £96,000 and have been recognised as additions within the acquired intangibles asset class. See note 19 for further details on this business acquisition.



## 10 Property, plant and equipment

	Freehold/ leasehold property £'000	Meter assets £'000	Plant and machinery £'000	Fixtures, fittings and equipment £'000	Motor vehicles £'000	Right-of- use assets £'000	Total £'000
<b>Cost</b>							
As at 1 January 2018	2,300	299,815	317	3,065	83	—	305,580
Additions	236	128,173	187	1,230	2,817	—	132,643
Disposals	—	(17,860)	—	(47)	(86)	—	(17,993)
As at 31 December 2018	2,536	410,128	504	4,248	2,814	—	420,230
Additions	215	95,186	520	2,498	3,279	4,889	106,587
Acquisitions	—	—	—	6	—	—	6
Reclassifications <sup>1</sup>	—	205	—	—	—	—	205
Impairment	—	—	—	—	—	(90)	(90)
Disposals	—	(21,991)	—	(894)	(65)	(54)	(23,004)
Exchange adjustments	—	—	—	—	—	—	—
<b>As at 31 December 2019</b>	<b>2,751</b>	<b>483,528</b>	<b>1,024</b>	<b>5,858</b>	<b>6,028</b>	<b>4,745</b>	<b>503,934</b>
As at 1 January 2018	392	37,820	71	1,868	83	—	40,234
Charge for year	127	20,390	162	794	323	—	21,796
Impairment	—	5,612	—	—	—	—	5,612
Disposals	—	(4,056)	—	(44)	(44)	—	(4,144)
As at 31 December 2018	519	59,766	233	2,618	362	—	63,498
Charge for year	(14)	31,491	267	1,337	1,139	917	35,137
Reclassifications <sup>1</sup>	—	74	—	—	—	—	74
Impairment	—	—	—	—	—	(37)	(37)
Disposals	—	(6,520)	—	(841)	(35)	—	(7,396)
<b>As at 31 December 2019</b>	<b>505</b>	<b>84,811</b>	<b>500</b>	<b>3,114</b>	<b>1,466</b>	<b>880</b>	<b>91,276</b>
<b>Net book value</b>							
<b>As at 31 December 2019</b>	<b>2,246</b>	<b>398,717</b>	<b>524</b>	<b>2,744</b>	<b>4,562</b>	<b>3,865</b>	<b>412,658</b>
As at 31 December 2018	2,017	350,362	271	1,630	2,452	—	356,732
As at 1 January 2018	1,908	261,995	246	1,197	—	—	265,346

<sup>1</sup> Capitalised development expenditure on ADM™ units has been reallocated from IT development and software in intangible assets to meter assets within property, plant and equipment, to align with the Group's accounting policy.

Right-of-use assets have been recognised following the implementation of IFRS 16. Of the £4,889,000 additions reported above, £3,820,000 relates to right-of-use assets recognised upon implementation on 1 January 2019. See note 29 for further details.

Included within the closing meter assets net book value of £398,717,000 (2018: £350,362,000) is £30,298,000 (2018: £43,049,000) relating to the traditional meter portfolio. In accordance with our accounting policy these assets will be written down to zero by 2022. In the 2019 consolidated financial statements the traditional meter portfolio generated £12,965,000 (2018: £13,216,000) revenue with a corresponding £11,184,000 (2018: £4,682,000) depreciation charge. £13,928,000 (2018: £12,853,000) annualised recurring revenue as at 31 December 2019 arises from the traditional meter portfolio.

The assets are secured by a bond and floating charge (note 17).

For the purpose of impairment testing the traditional meter asset portfolio recognised within "meter assets" is assessed as a stand-alone cash-generating unit (CGU) and its carrying amount is compared with the recoverable amount. See background information provided in the "Key sources of estimation uncertainty" section in the accounting policies. The recoverable amount is determined based on a value in use calculation, which uses the following key assumptions:

- estimated future cash flows from rental income, which are assumed to decline on a straight line basis;
- estimated future cash flows from termination income, which are derived using historical data and analysis around the risk of churn between contracted and non-contracted customers and the risk of recoverability once issued; and
- a pre-tax discount rate of 2.65%, which reflects the risk attached to the time value of these specific cash flows and is deemed to be best represented by the Group's incremental cost of borrowing on the basis that cash flows are secured by the installed meter and the risk inherent in the decline of the cash flows is already accounted for through the assumptions detailed above.

As a result of this impairment test, it was identified that the value in use exceeded the carrying value of the traditional meter assets CGU and, therefore, no impairment has been recognised in the year to 31 December 2019. An impairment charge of £5.6m was recognised in the year to 31 December 2018.

Management has performed sensitivity analysis on the key assumptions both with other variables held constant and with other variables simultaneously changed. Management has concluded that there are no reasonably possible changes in the key assumptions that would cause the carrying amounts of the traditional meter portfolio to exceed the value in use for either CGU.

No impairment on other meter assets was recognised in 2019.

## 11 Financial asset investments

	Shares in Group undertaking £'000	Unlisted investments £'000	Total £'000
<b>Cost</b>			
As at 1 January 2019	—	75	75
Impairment	—	—	—
<b>As at 31 December 2019</b>	<b>—</b>	<b>75</b>	<b>75</b>

## 12 Impairment of goodwill

The goodwill acquired in business combinations is allocated, at acquisition, to the CGUs that are expected to benefit from that business combination. Goodwill is monitored by management at the level of the CGUs (defined as the three operating segments) identified in note 1.

A segment-level summary of the goodwill allocation is presented below:

	Asset management £'000	Asset installation £'000	Energy management £'000	Total £'000
<b>Cost</b>				
As at 1 January 2019	4,112	3,497	—	7,609
Acquisitions (note 19)	—	—	995	995
Exchange adjustments	—	—	(57)	(57)
<b>As at 31 December 2019</b>	<b>4,112</b>	<b>3,497</b>	<b>938</b>	<b>8,547</b>

The goodwill recognised in energy management in the year ended 31 December 2019 has arisen on the acquisition of Solo Energy Limited, a blockchain energy flexibility IT platform. See note 19 for further details. Goodwill was allocated entirely to energy management on the basis that this is the operating segment that will receive the benefits from the acquisition.

The Group tests goodwill annually for impairment or more frequently if there are indications that goodwill might be impaired.

Goodwill is tested for impairment by comparing the carrying amount of each CGU, including goodwill, with the recoverable amount. The recoverable amounts are determined based on value in use calculations which require assumptions. The calculations use cash flow projections based on financial budgets approved by the Board covering a one-year period, together with management forecasts for a further four-year period. These budgets and forecasts have regard to historical performance and knowledge of the current market, together with the Group's views on the future achievable growth and the impact of committed cash flows. Cash flows beyond this are extrapolated using the estimated growth rates stated below.

The cash flows used in the value in use calculation for the asset management segment include all costs incurred in the provision of meter assets to energy suppliers, together with the initial installation. The cash flows used in the value in use calculation for the asset installation segment exclude installation costs incurred to fit an owned meter. For the purpose of the value in use calculation, these are instead allocated to the asset management segment, being the segment to which the corresponding revenues are allocated.

The annual impairment test was performed for the three CGUs identified above that have goodwill allocated to them. No evidence of impairment was found at the balance sheet date.

The key assumptions used in the value in use calculations for those CGUs that have goodwill allocated to them are as follows:

- **Perpetual growth rate** – the terminal cash flows are extrapolated in perpetuity using a growth rate of 3% for asset management (2018: 2.0%) and 0.5% for asset installation and energy management (2018: 2.0%). The rate of 3% applied to asset management is derived from historical Retail Price Index increases applied to the segment's index-linked meter rentals. This is not considered to be higher than the average long-term industry growth rate. The rate of 0.5% applied to asset installation and energy management is prudently aligned with the UK rate of inflation as revenues in these segments are not always index linked.
- **Discount rate** – the discount rate is initially based on the weighted average cost of capital (WACC) which would be anticipated for a market participant investing in the Group. A specific discount rate is then calculated for each operating segment, taking into account the time value of money, the segment's risk profile and the impact of the current economic climate. The pre-tax discount rates applied are 7.1%, 10.7% and 10.7% for asset management, asset installation and energy management respectively (2018: 7.2% for all three segments) and the post-tax discount rates applied are 5.9%, 8.9% and 8.9% for asset management, asset installation and energy management respectively (2018: 5.9% for all three segments).

Management has performed sensitivity analysis on the key assumptions both with other variables held constant and with other variables simultaneously changed. Management has concluded that there are no reasonably possible changes in the key assumptions that would cause the carrying amounts of goodwill to exceed the value in use for either CGU.

### 13 Inventories

	2019 £'000	2018 £'000
Finished goods	21,734	10,728
Consumables	327	533
	<b>22,061</b>	<b>11,261</b>

There has been a significant increase in inventory, with the strategic purchasing of SMETS2 meters to ensure the Group can meet forecast installations in the first part of 2020.

### 14 Trade and other receivables

	2019 £'000	2018 £'000
Trade receivables	28,596	17,582
Prepayments	1,944	1,090
Accrued income	15,490	10,454
Other receivables	1,655	944
VAT recoverable	602	570
	<b>48,287</b>	<b>30,640</b>

Trade receivables and accrued income include billed and unbilled receivables relating to our meter rental contracts. Amounts falling due after more than one year:

	2019 £'000	2018 £'000
Accrued income	232	402

Accrued income is made up of the following balances:

	2019 £'000	2018 £'000
Unbilled receivables	15,455	10,432
Contract assets	11	22
Other accrued income	24	—
	<b>15,490</b>	<b>10,454</b>

Unbilled receivables include receivables relating to our meter rental contracts.

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value.

The Group's credit risk is primarily attributable to trade receivables and accrued income. The amounts presented in the consolidated statement of financial position are net of any loss allowance. The total loss allowance for trade receivables and accrued income at 31 December 2019 was £4,413,000 (2018: £3,112,000). See note 18 for further details. The ageing profile of trade receivables past due date is shown below:

	2019 £'000	2018 £'000
31–60 days	6,623	1,761
61–90 days	2,228	1,662
Over 90 days	4,359	2,719
	13,210	6,142
Loss allowance	(4,284)	(2,356)
	8,926	3,786

Trade receivables are non-interest bearing and are generally on 30–90-day terms. Trade receivables due from related parties at 31 December 2019 amounted to £Nil (2018: £Nil).

Receivables are all in Sterling denominations.

Accrued income, which is made up of unbilled receivables and contract assets, is presented net of any loss allowance and impairment, with amounts being invoiced periodically and customers being the same as those within trade receivables.

### 15 Cash and cash equivalents

Cash and cash equivalents comprise cash held by the Group. The carrying amount of the asset approximates the fair value. All balances are held in Sterling.

During each period, there were no amounts of cash placed on short-term deposit.

For the purposes of the cash flow statement, cash and cash equivalents comprises:

	2019 £'000	2018 £'000
Cash	50,092	30,027
	50,092	30,027

### 16 Trade and other payables

	2019 £'000	2018 £'000
<b>Current</b>		
Trade payables	16,466	13,835
Other payables	2,420	775
Other taxes	4,788	2,628
Deferred income	2,487	3,540
Advance payments	1,335	1,345
Accruals	19,300	14,225
	46,796	36,348

Deferred income and advance payments are made up of the following balances:

	2019 £'000	2018 £'000
Contract liabilities	3,494	3,229
Other deferred income	328	1,656
	3,822	4,885

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

Trade payables are classified at amortised cost, are non-interest bearing and are normally settled on 30–45-day terms.

All trade liabilities are denominated in Sterling.

## 17 Financial liabilities

	2019 £'000	2018 £'000
<b>Current</b>		
Lease liabilities	1,013	—
Bank loans	1,724	172,016
	<b>2,737</b>	<b>172,016</b>
<b>Non-current</b>		
Lease liabilities	2,950	—
Bank loans	267,536	—
	<b>270,486</b>	<b>—</b>

Bank loans at 31 December 2018 relate to a revolving credit facility of £280m.

On 21 December 2018, the Group entered into a new revolving credit facility agreement with a syndicate of banks for £420m, available for five years (the new facility). This new facility comprises a different banking structure, gives rise to a significant increase in the Group's borrowing capacity and discharged the Group's obligations under the previous facility with effect from the first utilisation on 3 January 2019. It is thus deemed to be an extinguishment.

On 3 January 2019, the first drawdown was made under the new facility for £200m. This was used to settle the Group's outstanding obligations under the previous facility of £172m and fund additional capital investment. The drawdown pattern changes under the new facility to quarterly in advance, rather than monthly in arrears. The balance of unamortised arrangement fees on the previous facility of £0.1m has been accelerated and recognised as an exceptional finance cost in the consolidated income statement for the year ended 31 December 2019.

Transaction costs on the new facility of £3.1m, deferred within other assets at 31 December 2018 and also recognised within other liabilities, were reclassified to bank loans on 3 January 2019 and are amortised over the term of the new facility. At 31 December 2019, £0.6m of transaction costs had been recognised within the consolidated income statement.

The Group had a total outstanding principal of £270m at 31 December 2019. Repayment of the principal is not required until 2022 under the terms of the contract and, therefore, this balance has been classified as non-current at 31 December 2019. Accrued interest of £1.7m has been recognised as part of the carrying value of bank loans at 31 December 2019 together with a deduction of £2.5m for unamortised transaction costs.

In 2019, the new facility attracted interest at a rate of 1.85% over the three-month LIBOR and 0.65% was payable on undrawn funds. The interest is required to be settled quarterly and has thus been classified as current at 31 December 2019.

The Group has complied with the financial covenants of its borrowing facility during the 2019 and 2018 reporting period.

Following the announcement on 12 March 2020 that the Group has signed an agreement to dispose of a minority of the Group's meter assets, as detailed in note 28(a), the Group intends to fully repay the existing debt facility in 2020 and replace it with an amended £300m revolving credit facility on the same terms.

### 17 (a) Changes in liabilities arising from financing activities

Financial liabilities	Lease liabilities £'000	Bank loans £'000
At 1 January 2018	—	187,084
Cash flows (i)	—	(15,654)
Other non-cash changes (i)	—	586
At 31 December 2018	—	172,016
Recognition on adoption of IFRS 16 (see note 29)	3,868	—
At 1 January 2019	3,868	172,016
Cash flows (i)	(1,075)	90,149
New leases	1,040	—
Other non-cash changes (i)	130	7,095
<b>At December 2019</b>	<b>3,963</b>	<b>269,260</b>

*(i) Cash flows and other non-cash changes*

Cash flows lease liabilities include £1,075,000 of lease payments. Cash flows on bank loans include £270,000,000 of new borrowings less £172,114,000 of borrowings repaid, interest payments of £4,632,000 and a payment of £3,105,000 for arrangement fees.

Other non-cash changes in lease liabilities include £157,000 of interest charges less £27,000 arising from changes in lease terms in the year. Other non-cash changes in bank loans include £6,356,000 of interest charges, of which £1,724,000 were unpaid at 31 December 2019, and £739,000 amortisation of arrangement fees.

In 2018, cash flows on bank loans included £101,627,000 of new borrowings less £117,281,000 of borrowings repaid. Other non-cash changes in bank loans included £586,000 amortisation of arrangement fees.

**18 Financial risk management**

The Board reviews and agrees policies for managing the risks associated with interest rate, credit and liquidity risk. The Group has in place a risk management policy that seeks to minimise any adverse effect on the financial performance of the Group by continually monitoring the following risks:

**18 (a) Interest rate risk**

The Group's main interest rate risk arises from its floating rate bank loan of £269,260,000 (2018: £172,016,000). See note 17 for further details.

There were no overdrafts at 31 December 2019 (2018: none) and the interest charge arising on lease liabilities, recognised from 1 January 2019 upon implementation of IFRS 16, does not represent a cash interest rate risk for the Group.

The Group's financial assets at 31 December 2019 comprise cash and trade receivables. The cash balance of £50,092,000 (2018: £30,027,000) is a floating rate financial asset but interest income is not typically material.

*(i) Interest rate sensitivity*

The following table demonstrates the sensitivity to a change in interest rates on the Group's floating rate bank loan. The Group's profit before tax is affected through the impact on floating rate borrowings as follows:

	Increase/decrease in basis points	Effect on profit before tax £'000
<b>2019</b>	<b>+70bps</b>	(1,885)
<b>2018</b>	<b>+70bps</b>	(1,204)

Management believes that a movement in interest rates of 70bps gives a reasonable measure of the Group's sensitivity to interest rate risk. The table above demonstrates the sensitivity to a possible change in interest rates, with all other variables held constant, of the Group's profit before tax.

**18 (b) Fair values of financial liabilities and financial assets**

The Group's bank loan is measured at amortised cost. For fair value disclosure purposes, the bank loan is considered to be a level 2 financial instrument on the basis that it is not traded in an active market. The fair values, based upon the market value or discounted cash flows of financial liabilities and financial assets held in the Group, were not materially different from their book values.

**18 (c) Foreign currency risk**

The Group's exposure to the risk of changes in foreign exchange primarily arises from a single subsidiary acquired during the year, operating in Euros. With the exception of this entity, all of the Group's operating activities are denominated in Pounds Sterling and, therefore, the Group's overall exposure is not significant.

**18 (d) Liquidity risk**

The Group manages its cash in a manner designed to ensure maximum benefit is gained whilst ensuring security of investment sources. The Group's policy on investment of surplus funds is to place deposits at institutions with strong credit ratings; this is considered to be institutions with a credit rating of AA– and above. Currently, all of the chosen investment institutions are in line with these criteria.

The ageing and maturity profile of the Group's material financial liabilities is disclosed in the table below. The amounts disclosed are the contractual undiscounted cash flows.

	Less than one year £'000	Between two and five years £'000	Over five years £'000	Total contractual cash flows £'000
<b>31 December 2019</b>				
<b>Contractual maturities of financial liabilities</b>				
Trade payables	16,466	—	—	<b>16,466</b>
Bank loan	7,049	290,954	—	<b>298,003</b>
Lease liabilities	1,153	2,748	456	<b>4,357</b>
	<b>24,668</b>	<b>293,702</b>	<b>456</b>	<b>318,826</b>

The contractual undiscounted cash flows on the bank loan reflect the contractual arrangements in place at 31 December 2019. As disclosed in note 28(a), the Group intends to fully repay the existing debt facility in 2020. Of the £290,954,000 disclosed in the 2019 bank loan time band “between two and five years”, the Group has assumed that the entire principal balance will be settled upon maturity of the loan facility at the end of 2023.

	Less than one year £'000	Between two and five years £'000	Over five years £'000	Total contractual cash flows £'000
<b>31 December 2018</b>				
<b>Contractual maturities of financial liabilities</b>				
Trade payables	13,835	—	—	13,835
Bank loan <sup>1</sup>	172,016	—	—	172,016
Lease liabilities	—	—	—	—
	<b>185,851</b>	<b>—</b>	<b>—</b>	<b>185,851</b>

<sup>1</sup> In 2018, there was a nil variable interest rate impact given the full loan balance at 31 December 2018 was considered short term and was extinguished on 3 January 2019.

### **18 (e) Credit risk**

The Group's credit risk primarily arises from credit exposures to energy suppliers (our customers), including outstanding receivables, due to the Group trading with a limited number of companies, which are generally large utility companies or financial institutions.

Credit risk is managed on a Group basis. For banks and financial institutions, only independently rated parties with a minimum rating of “AA–” are accepted. With regard to customers, the Group assesses the credit quality of the customer, considering its financial position, past experience and other factors. The Group does not expect, in the normal course of events, that debts due from customers are at significant risk. The Group's maximum exposure to credit risk equates to the carrying value of cash and cash equivalents, trade and other receivables, contract assets and investments. The Group's maximum exposure to credit risk from its customers is £44,318,000 (2018: £28,438,000) being the sum of the carrying value of trade receivables and accrued income, including contract assets, as disclosed within trade and other receivables in note 14. The Group regularly monitors and updates its cash flow forecasts to ensure it has sufficient and appropriate funds to meet its ongoing operational requirements.

#### **(i) Impairment of financial assets**

The Group has two types of financial assets that are subject to IFRS 9's expected credit loss model:

- trade receivables, which consist of billed receivables arising from contracts with customers, for the provision of meter asset installation, management and energy services; and
  - accrued income, which consists of contract assets and unbilled receivables arising from contracts with customers.
- While cash and cash equivalents, and debt investments held at amortised cost, are also subject to the impairment requirements of IFRS 9, the identified impairment loss was immaterial.

The Group applies the IFRS 9 simplified approach to measuring forward-looking expected credit losses (ECL) which uses a lifetime expected loss allowance for all trade receivables and accrued income, including contract assets.

To measure the ECL, trade receivables and accrued income have been grouped based on shared credit risk characteristics and the days past due. Accrued income relates to rights to consideration for performance, and other operating charges, before payment is due from customers and consists of unbilled receivables and contract assets (see note 2 for details). These have substantially the same risk characteristics as the trade receivables for the same types of contracts. The Group has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for accrued income.

The Group has established a provision matrix based on the payment profiles of sales, over the most recent twelve-month period that is an appropriate representation of loss patterns, and the corresponding historical credit losses experienced within this period. The historical loss rates are adjusted to reflect current and forward-looking information that might affect the ability of customers to settle the receivables, including macroeconomic factors as relevant. In

calculating the loss rates, certain historical losses arising from specific circumstances with customers have been removed where these are not indicative of future loss patterns.

On that basis, the loss allowance at 31 December 2019 was determined as £4,413,000 (31 December 2018: £3,112,000) for trade receivables and accrued income. A reconciliation of these balances is provided as follows:

	Accrued income £'000	Trade receivables £'000	Total £'000
At 1 January 2019	756	2,356	3,112
(Decrease)/Increase in loss allowance recognised in profit or loss during the year	(627)	4,012	3,385
Receivables written off during the year as uncollectable	—	(2,084)	(2,084)
Unused amount reversed	—	—	—
<b>At 31 December 2019</b>	<b>129</b>	<b>4,284</b>	<b>4,413</b>

Total trade receivables have increased since the prior year end, contributing to the increase in loss allowance recognised at 31 December 2019. In addition, the loss allowance at 31 December 2019 includes certain individually impaired trade receivables as a result of specific circumstances with customers. The decrease in the loss allowance on accrued income reflects the application of updated loss rates and an overall decrease in accrued termination income as compared with the prior year. Total net impairment losses on financial and contract assets were £3,385,000 in 2019 (2018: £2,409,000). Of this amount, £3,385,000 (2018: £2,366,000) relates to amounts arising from trade receivables and accrued income.

*(ii) Fair value*

There is no material difference between the book value and the fair value of any financial asset or liability.

**18 (f) Capital management**

Capital is the equity attributable to the equity holders of the parent. The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value. The Group manages its capital structure, and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, sell assets, return capital to shareholders or issue new shares.

The Group monitors capital on the basis of a leverage ratio. This ratio is calculated as net debt divided by pre-exceptional EBITDA. Net debt is calculated as total borrowings less cash. Pre-exceptional EBITDA is calculated as operating profit before any significant exceptional items, interest, tax, depreciation and amortisation.

The objective of SMS's strategy is to deliver long-term value to its shareholders whilst maintaining a balance sheet structure that safeguards the Group's financial position. From an ordinary dividend perspective our objective has been to provide a progressive, through-cycle dividend that reflects the potential volatility of our business. A revised dividend policy has been proposed, effective in FY20, following the disposal of a minority of the Group's meter assets. See note 28(a) for further details.

**19 Business combinations**

On 5 September 2019 the Group acquired 100% of the issued share capital of Solo Energy Limited (company number 566746), a blockchain energy flexibility IT platform. The acquisition will enable SMS to utilise Solo's IT platform, which was still under development at 31 December 2019, to establish new long-term revenue streams from a decentralised energy grid.

The company's registered office address is Phoenix House, Monahan Road, Cork T12 H1XY, and it reports in Euros. Purchase consideration consisted of cash only. Total cash paid was 1,152,000 EUR (equivalent to £1,032,000 using an exchange rate of 1.1163 at 5 September 2019).



The assets and liabilities recognised as a result of the acquisition are as follows:

	Fair value £'000 <sup>1</sup>
Intangible assets: capitalised development	697
Intangible assets: trademarks	96
Plant and equipment	6
Cash and cash equivalents	5
Trade and other receivables	4
Trade and other payables	(230)
Deferred income: government grants	(24)
Borrowings	(334)
Deferred tax liability	(16)
<b>Net identifiable assets acquired</b>	<b>204</b>
Less: pre-existing relationship	(167)
Add: goodwill	995
<b>Net assets acquired</b>	<b>1,032</b>

<sup>1</sup> All net assets acquired have been translated using an exchange rate of 1.1163 at 5 September 2019.

No contingent assets or liabilities were acquired.

In addition to the borrowings acquired above of £334,000 Solo Energy Limited had a short-term loan of £167,000 due to an SMS subsidiary company at the date of acquisition. In accordance with IFRS 3, this pre-existing relationship is accounted for as "effectively" settled on acquisition by increasing the consideration transferred for the acquisition. The acquisition of Solo Energy Limited and the effective settlement of the receivable are recorded as separate transactions. No gain or loss has been recognised as the receivable due from Solo Energy Limited was effectively settled at the recorded amount.

The goodwill is attributable to management expertise and the new, long-term revenue opportunities expected from the deployment of Solo Energy's IT platform. Goodwill will not be deductible for tax purposes.

The IT platform acquired was still under development at 31 December 2019. Therefore, for the period from 5 September to 31 December 2019, the acquired business contributed immaterial revenues and a net loss before taxation of £120,000 to the Group. If the acquisition had occurred on 1 January 2019, consolidated pro-forma revenue for the year ended 31 December 2019 would also have been immaterial and consolidated pro-forma loss for the year ended 31 December 2019 would have been approximately £384,000. No further adjustments were required as there were no material differences in the accounting policies between the Group and the entities acquired.

Acquisition related costs of £92,000 were incurred and are included as part of exceptional administrative costs in the consolidated statement of comprehensive income.

There were no acquisitions in the year ending 31 December 2018.

## 20 Deferred taxation

The movement in the deferred taxation liability during the period was:

	2019 £'000	2018 £'000
Opening deferred tax liability	12,070	9,924
Increase in provision through consolidated statement of comprehensive income	1,544	1,052
Increase/(decrease) in provision through equity	149	1,094
Deferred tax on intangibles acquired as part of acquisitions	16	—
Closing deferred tax liability	13,779	12,070

The Group's provision for deferred taxation consists of the tax effect of temporary differences in respect of:

	2019 £'000	2018 £'000
Excess of taxation allowances over depreciation on property, plant and equipment	11,691	12,170
Tax losses available	(1)	(96)
Deferred tax asset on share options	(992)	(1,056)
Deferred tax on intangibles acquired	58	147
Other	3,023	905
	13,779	12,070

The deferred tax included in the consolidated statement of comprehensive income is as follows:

	2019 £'000	2018 £'000
Accelerated capital allowances	(478)	613
Tax losses	95	(35)
Deferred tax asset on share options	(85)	(152)
Movement in fair value of intangibles	(106)	(280)
Other	2,118	906
	<b>1,544</b>	<b>1,052</b>

The Group had unrecognised tax losses of £763,000 in a subsidiary undertaking at 31 December 2019.

The main rate of corporate taxation is expected to reduce from 19% to 17% effective 1 April 2020, as a result of the Finance Act 2016, which was substantively enacted on 6 September 2016. Consequently, deferred tax has been provided at the tax rates at which temporary differences are expected to reverse.

## 21 Related party transactions

### 21 (a) Subsidiaries

The Group's subsidiaries at 31 December 2019 are set out below. Unless otherwise stated, they have share capital consisting solely of ordinary shares, and the proportion of ownership interests held equals the voting rights held by the Group. The country of registration is also their principal place of business.

	Registered office	Holding	Proportion of shares held	Nature of business
SMS Connections Limited	1	Ordinary shares	100%	Gas utility connections
SMS Meter Assets Limited	1	Ordinary shares	100%	Gas and electric asset management
SMS MAPCO 1 Limited	1	Ordinary shares	100%	Gas and electric asset management
Crail Meters Limited*±	1	Ordinary shares	100%	Gas and electric asset management
SMS Data Management Limited	1	Ordinary shares	100%	Data management
UKMA (AF) Limited*	2	Ordinary shares	100%	Funding
SMS Corporate Services Limited±	1	Ordinary shares	100%	Administrative services
SMS Energy Services Limited	2	Ordinary shares	100%	Electricity utility connections and management
CH4 Gas Utility and Maintenance Services Limited*	2	Ordinary shares	100%	Meter installation
SMS Utilities Academy Limited**±	2	Ordinary shares	100%	Engineer training and development
Trojan Utilities Limited*	2	Ordinary shares	100%	Meter installation
Qton Solutions Limited*	2	Ordinary shares	100%	Business and domestic software development
Solo Energy Limited (UK)*±	1	Ordinary shares	100%	Renewable asset management
Solo Energy Limited (Ireland)*	±	3 Ordinary shares	100%	Renewable asset management

\* The shareholding in this company is indirect via a subsidiary company.

± Newly incorporated entity in 2019.

1 Registered office address: 2nd Floor, 48 St. Vincent Street, Glasgow G2 5TS.

2 Registered office address: Prennau House, Copse Walk, Cardiff Gate Business Park, Cardiff CF23 8XH.

3 Registered office address: Phoenix House, Monahan Road, Cork T12 H1XY.

### 21 (b) Key management personnel compensation

The Group has determined that key management personnel constitute the Executive Directors, Non-executive Directors and certain senior management personnel. The aggregate compensation paid or payable to key management is shown below:

	2019 £'000	2018 £'000
Short-term employee benefits	1,557	2,369
Post-employment benefits	22	23
Share-based payments	186	114
	<b>1,765</b>	<b>2,506</b>

## 21 (c) Directors

### (i) Directors' emoluments

Aggregate remuneration for both Executive and Non-executive Directors in respect of qualifying services was:

	2019 £'000	2018 £'000
Aggregate emoluments	877	1,281
Company contributions to money purchase pension scheme	11	8
Company contributions to private pension plan	—	—
	<b>888</b>	<b>1,289</b>

In 2019, no amount was payable to Directors as settlements following resignation (2018: no amount was payable to Directors).

### (ii) Emoluments of highest paid Director

	2019 £'000	2018 £'000
Emoluments	377	663

In addition, rent was paid into the highest paid Director's personal pension scheme. See note 21 (d) for further details.

### (iii) Number of Directors who accrued benefits under Company pension schemes

	2019 Number	2018 Number
Money purchase schemes	2	1

## 21 (d) Other transactions with related parties

A number of key management personnel hold positions in other entities that result in them having control or significant influence over the financial or operating policies.

A number of these entities transacted with the Group in the reporting period. The terms and conditions of the transactions with key management personnel and their related parties were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to non-key management personnel and related entities on an arm's length basis.

During the period, the Group entered into the following transactions with related parties:

- Rent amounting to £41,500 (2018: £41,615) paid to the Directors' pension scheme, Eco Retirement Benefit Scheme, for the use of certain premises. Alan Foy is a trustee of the scheme. At the year-end date, an amount of £Nil (2018: £Nil) was outstanding in this regard.
- The Group paid dividends to Alan Foy of £281,382 (2018: £244,641), The Metis Trust<sup>1</sup> of £56,520 (2018: £49,140), David Thompson of £84 (2018: £27), Miriam Greenwood of £1,046 (2018: £893), Willie MacDiarmid<sup>2</sup> of £372 (2018: £323), Graeme Bissett of £333 (2018: £289) and Tim Mortlock of £121 (2018: £Nil).
- During the year, SMS Utilities Academy Limited purchased a group of assets and liabilities for £27,500 from Utilities Academy Limited – a third-party smart meter training facility in which another subsidiary undertaking, Trojan Utilities Limited, had a minority shareholding. The net assets purchased were previously used by Utilities Academy Limited in its business of providing training to dual fuel smart meter engineers on behalf of third-party customers. Utilities Academy Limited went into administration on 28 March 2019, at which point the cost of Trojan Utilities Limited's minority investment in the company was written off. At 31 December 2018 Trojan Utilities Limited had a balance with Utilities Academy Limited of £26,442 with transactions during the year amounting to £Nil.

1 Alan Foy is a trustee but not a beneficiary.

2 Paid to a connected person.

## 22 Share capital

	2019 £'000	2018 £'000
Allotted and called up:		
112,811,122 ordinary shares of £0.01 each (2018: 112,548,050 ordinary shares of £0.01 each)	1,128	1,125

During the year 125,519 (2018: 97,250) ordinary share options were exercised in relation to the Group's employee share plans which are described in note 23. The ordinary shares issued have a nominal value of £1,000 (2018: £1,000), and aggregate consideration of £419,000 (2018: £270,000) was received.

In addition, 137,553 shares were issued during the year (2018: nil) in relation to deferred remuneration arising on the acquisition of a subsidiary in 2016, settled in shares in April 2019. The ordinary shares issued have a nominal value of £2,000 and a fair value of £829,000. No consideration was received for these shares. The total fair value of £829,000 has been recognised directly within retained earnings and the difference between the fair value and nominal value of £827,000 has been recognised within share premium.

The Group's Share Incentive Plan is administered by the Smart Metering Systems SIP Trust (the trust), which acquires shares in SMS (own shares) to satisfy awards under this plan and facilitate the delivery of shares to participants. At 31 December 2019, 146,412 (2018: 111,307) own shares were held in trust with a carry value of £768,000 and a market value of £827,000 (2018: £584,000). The Company purchased 67,220 shares (2018: 36,137) from the market during 2019 with a weighted average fair value of £5.20 per share (2018: £6.34).

## 23 Share-based payments

### 23 (a) Employee option plans

On 20 June 2011 the Company adopted both the Approved Company Share Option Plan (CSOP) and the Unapproved Share Option Plan (the Unapproved Plan).

The CSOP is open to any employee of any member of the Group up to a maximum value of £30,000 per employee. The Unapproved Plan is open to any employee, including Executive Directors, of the Company or any other Group company who is required to devote substantially the whole of their time to their duties under his contract of employment.

Under the plans, participants are granted options which, except in certain specified circumstances, only vest if certain performance conditions are met and the employee is still in service within five years of the date of grant. The performance conditions for awards are based on market capitalisation and individual performance targets. Once vested, the options remain exercisable for a period of up to ten years from the date of grant. The exercise price of the options is determined by the Directors but shall not be less than the closing price at which the Company's shares are traded on the date of grant.

(i) *Summary of options*

The table below summarises options granted under the CSOP and Unapproved Plan:

Plan	At 1 January 2019	Granted	Exercised	Forfeited	Expired	At 31 December 2019	Exercise price (pence)	Date exercisable	Expiry date	Fair value at grant (pence)
CSOP	27,253	—	(1,400)	—	—	<b>25,853</b>	76.0	15 Jul 2014	15 Jul 2021	17.1
Unapproved	321,666	—	—	—	—	<b>321,666</b>	60.0	20 Jun 2016	20 Jun 2021	13.0
Unapproved	405,000	—	(25,000)	—	—	<b>380,000</b>	153.5	28 May 2017	28 May 2022	40.0
Unapproved	65,000	—	—	(25,000)	—	<b>40,000</b>	350.0	12 Nov 2019	12 Nov 2024	84.8
Unapproved	698,019	—	(22,544)	(15,693)	(1,904)	<b>657,878</b>	350.0	12 Nov 2019	12 Nov 2024	84.8
Unapproved	161,724	—	(76,575)	(51,050)	—	<b>34,099</b>	391.8	20 Mar 2021	19 Mar 2026	61.5
Unapproved	38,586	—	—	—	—	<b>38,586</b>	410.0	4 Jul 2021	3 Jul 2026	114.3
Unapproved	90,706	—	—	—	—	<b>90,706</b>	470.0	18 Aug 2021	17 Aug 2026	87.2
Unapproved	100,000	—	—	—	—	<b>100,000</b>	529.0	1 Sep 2021	31 Aug 2026	141.5
Unapproved	50,000	—	—	—	—	<b>50,000</b>	529.0	26 Sep 2021	25 Sep 2026	142.4
Unapproved	9,091	—	—	—	—	<b>9,091</b>	550.0	28 Nov 2021	28 Nov 2026	141.0
Unapproved <sup>1</sup>	489,001	—	—	(10,000)	—	<b>479,001</b>	700.0	1 Jan 2023	13 Jul 2028	125.2
Unapproved <sup>3</sup>	12,000	—	—	—	—	<b>12,000</b>	602.8	13 Sep 2023	12 Sep 2028	154.3
Unapproved <sup>2</sup>	—	489,000	—	(10,000)	—	<b>479,000</b>	700.0	1 Jan 2023	13 Jul 2028	34.6
Unapproved <sup>3</sup>	—	12,000	—	—	—	<b>12,000</b>	602.8	13 Sep 2023	12 Sep 2028	98.0
Unapproved	—	370,000	—	—	—	<b>370,000</b>	454.6	5 Sep 2024	4 Sep 2029	111.5
<b>Total</b>	<b>2,468,046</b>	<b>871,000</b>	<b>(125,519)</b>	<b>(111,743)</b>	<b>(1,904)</b>	<b>3,099,880</b>				

1 Options of 489,001 relate to the first of five tranches. Remaining tranches will be granted in line with plan rules.

2 Options of 489,000 relate to the second of five tranches. Remaining tranches will be granted in line with plan rules.

3 Options of 12,000 and 12,000, respectively, relate to the first and second of five tranches. Remaining tranches will be granted in line with plan rules.

The weighted average share price at the date of exercise of options exercised during the year ended 31 December 2019 was £5.39 (2018: £7.59).

(ii) *Fair value of options granted*

The assessed fair value at the valuation date of options granted during the year ended 31 December 2019 ranged from 34.6p to 111.5p, as disclosed in the table above (2018: 125.2p to 154.3p). The fair value of options granted is estimated using appropriate option pricing models, taking into account the exercise price, the term of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield, the risk-free rate interest rate for the term of the option, and the market-based performance conditions. The expected price volatility is based on historical volatility, adjusted for any expected changes to future volatility due to publicly available information.

The total fair value of these options is recognised over the period from their grant date until they become exercisable.

The following table lists the range of assumptions applied to the options granted under the Unapproved Plan during the year ended 31 December 2019:

Dividend yield (%)	1.00 to 1.37
Expected volatility (%)	30.32 to 30.55
Risk-free interest rate (%)	0.43 to 0.60
Expected option life (years)	4.04 to 5.00
Exercise price (£)	4.55 to 7.00
Share price at grant date (£)	4.64 to 5.31
Fair value at grant date (£)	0.35 to 1.12

Where the options granted have a market performance condition attached, the Group has used a Monte Carlo model in order to allow for the impact of this condition. Where there is no market performance condition attached, the Group has used the traditional Black-Scholes model. The dividend yield was determined using the published yield at the date of grant. The expected volatility reflects the assumption that historical volatility, as measured over several different periods, is indicative of future trends, which may not necessarily be the actual outcome. The risk-free interest rate is taken from a government bond yield rate with a redemption period consistent with the corresponding vesting period of the options. The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur.

The expense recognised in 2019 for all options is £353,000 (2018: £282,000).

### 23 (b) Share Incentive Plan (SIP)

The Company introduced the SIP in October 2014. All employees of the Group (including Executive Directors) are eligible to participate in the SIP. Participants may each acquire Partnership Shares worth up to £1,800 per year from their pre-tax earnings at market value. The Company awards participants one Matching Share for each Partnership Share which they acquire. Dividends received on shares held in the SIP are reinvested to acquire Dividend Shares at market value. Matching Shares may be forfeited if the participant disposes of the corresponding Partnership Shares or leaves the employment of the Group within three years of the award date.

The table below shows the number of shares held in the SIP at the beginning and end of the year.

Type of award	At 1 January 2019	Awarded shares	Sold/transferred	Forfeited	At 31 December 2019	Weighted average acquisition price
Partnership	158,961	71,145	(26,776)	(83)	<b>203,247</b>	£5.25
Matching	157,624	71,145	(13,216)	(14,638)	<b>200,915</b>	£5.25
Dividend	3,617	5,302	(617)	(12)	<b>8,290</b>	£5.47
<b>Total</b>	<b>320,202</b>	<b>147,592</b>	<b>(40,609)</b>	<b>(14,733)</b>	<b>412,452</b>	

The SIP is administered by the Smart Metering Systems SIP Trust. To the extent sufficient shares are not already held by the trust, Matching Shares awarded by the trust to employees are acquired on market prior to the award. Matching Shares held by the trust, which have not yet vested unconditionally at the end of the reporting period, are shown as own shares in the financial statements.

The fair value of the Matching Shares at the award date is equal to the share price at the award date. The weighted average fair value per share of the Matching Shares awarded during 2019 was approximately £5.26 per share (2018: £6.56). The total fair value of Matching Shares awarded is recognised over the three-year period starting on the respective award dates.

The expense recognised in 2019 for all Matching Shares is £250,000 (2018: £206,000). No expense is recognised for the Partnership Shares and Dividend Shares because the participants pay full market value for these shares.

### 24 Other reserve

This is a non-distributable reserve that initially arose by applying merger relief under section 612 of the Companies Act 2006 to the shares issued in 2009 in connection with the Group restructuring. Additionally, the premium of £4,189,000 and £1,115,000 arising on the issue of shares as part of the acquisitions of CH4 Gas Utility and Maintenance Services Limited (CH4), Trojan Utilities Limited (Trojan) and Qton Solutions Limited (Qton) has been credited to this reserve.

### 25 Commitments under operating leases

The Group's commercial leases for certain vehicles, office and warehouse space are accounted for under IFRS 16 with effect from 1 January 2019 and are thus excluded from the below operating lease commitments disclosure in 2019. These were previously included in the prior year. See note 29 for further details on the implementation of IFRS 16.

2019 commitments under operating leases include the Group's commercial leases for its fleet vans and items of office equipment. These leases are either short term (the contract term is less than twelve months) or low value (underlying asset less than \$5,000) and, therefore, meet the exemption criteria under IFRS 16. They continue to be expensed through the consolidated statement of comprehensive income. These leases have lives between one and three years and some have renewal options included in the contracts. There are no restrictions placed upon the Group by entering into these leases.

Future minimum rentals payable under non-cancellable operating leases as at each year end are as follows:

	2019 £'000	2018 £'000
Future minimum commitments under operating lease agreements are as follows:		
Payable within one year	<b>61</b>	1,258
Payable within two and five years	<b>19</b>	2,841
Payable after five years	<b>—</b>	861
	<b>80</b>	4,960

### 26 Capital commitments

Significant capital expenditure contracted for at the end of the reporting period but not recognised as liabilities is as follows:

	2019 £'000	2018 £'000
Property, plant and equipment	<b>579</b>	—
Intangible assets	<b>1,233</b>	2,430

Included within the capital expenditure on intangible assets is £1,041,000 (2018: £2,430,000) in relation to the implementation of a new ERP system across the Group.

## **27 Ultimate controlling party**

There is no ultimate controlling party by virtue of the structure of shareholdings in the Group.

## **28 Post balance sheet events**

### **28 (a) Sale of a minority of meter assets**

As announced on 12 March, the Group has signed an agreement to dispose of a minority of the Group's meter assets for a total gross cash consideration of £291 million. Following the deduction of transaction and other expenses, and subject to completion of the disposal (which is expected to take place on 22 April 2020), the Group expects to receive net cash consideration of £282 million.

The meters being disposed of have a net book value of £89m at 31 December 2019 and the transaction is expected to result in a gain of approximately £193 million, which will be disclosed as an exceptional item in the financial statements. The disposal will be effected by the sale of the entire share capital of Crail Meters Limited, a wholly owned subsidiary of the Group.

SMS will continue to manage the disposed meter portfolio on behalf of the purchaser, for which it will receive RPI-linked management fees of £0.8 million in the first full year.

The Group also announced a revised dividend policy, with a proposed annual dividend of 25p per share for FY2020 increasing at least in line with RPI until FY2024, and a scrip alternative offer for up to 30% of the dividend.

Linked to this transaction, the Group intends to fully repay the existing debt facility and replace it with an amended £300m revolving credit facility on the same terms.

### **28 (b) Budget 2020 announcement**

Deferred tax has been provided on the consolidated balance sheet at 31 December 2019 at a rate of 17%; being the rate which was substantively enacted at the balance sheet date (effective 6 September 2016). The Budget 2020, announced on 11 March 2020, has confirmed that the decrease from 19% to 17%, previously due to become effective from 1 April 2020, will no longer occur once draft legislation is passed. The impact of this change would result in an increase to closing deferred tax liabilities of £1.6m.

### **28 (c) Coronavirus**

As the situation continues to evolve, our primary concern is for the welfare of our people. We are following the development of the coronavirus outbreak and have implemented several immediate measures to protect our employees and to prepare for possible consequences of the virus. Whilst the outbreak has not yet had any direct impact on our operations, it is unclear how it will develop. It is currently difficult to assess the potential impact this could have on our 2020 business activities and results, but based on the current financial position of the Group, together with the cash that will be generated upon completion of the asset disposal detailed in note 28(b), we are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. We will continue to follow developments closely and are prepared to take further action as appropriate.

## **29 Impact of change in accounting policies on the financial statements**

This note explains the impact of the adoption of IFRS 16 Leases on the Group's financial statements and discloses the new accounting policies that have been applied from 1 January 2019 in note 29 (b) below.

The Group has adopted IFRS 16 retrospectively from 1 January 2019 but has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019.

### **29 (a) Adjustments recognised on adoption of IFRS 16**

The change in accounting policy affected the following items in the consolidated balance sheet on 1 January 2019:

- right-of-use assets – increased by £3,820,000, recognised within property, plant and equipment;
- lease liabilities – increased by £3,868,000 (of which £3,173,000 were non-current), recognised separately on the consolidated balance sheet; and
- prepayments and accruals – decreased by £140,000 and £187,000 respectively.

On adoption of IFRS 16, the Group recognised lease liabilities in relation to leases which had previously been classified as “operating leases” under the principles of IAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee’s incremental borrowing rate as of 1 January 2019. The weighted average lessee’s incremental borrowing rate applied to the lease liabilities on 1 January 2019 and 31 December 2019 was 4%.

There was no net impact to retained earnings on 1 January 2019 and thus no impact to taxation on transition.

For the year ended 31 December 2019 there has been no material impact on operating profit or EBITDA but a portion of expense previously recognised within administrative expenses has been recognised as a finance cost under IFRS 16.

The Group had no leases previously classified as finance leases at 1 January 2019.

Differences between the operating lease commitments disclosed at 31 December 2018, discounted using the incremental borrowing rate at the date of initial application of IFRS 16, and the lease liabilities recognised in the consolidated balance sheet at 1 January 2019 comprise adjustments for prepayments and rent-free periods together with short-term and low-value leases recognised on a straight line basis as administrative expenses.

The associated right-of-use assets for leases were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet as at 31 December 2018. There were no onerous lease contracts that would have required an adjustment to the right-of-use assets at the date of initial application.

The recognised right-of-use assets relate to the following types of assets:

	<b>At 31 December 2019 £'000</b>	<b>At 1 January 2019 £'000</b>
Cost		
Properties <sup>1</sup>	<b>3,845</b>	3,806
Motor vehicles	<b>19</b>	14
<b>Total right-of-use assets</b>	<b>3,864</b>	3,820

1 Properties include office and warehouse space.

*(i) Impact on segment disclosures and earnings per share*

The asset management EBITDA, segment assets and segment liabilities for December 2019 all increased as a result of the change in accounting policy.

Lease liabilities and corresponding right-of-use assets are now included in the asset management segment liabilities and assets to the extent they relate to properties (i.e. warehouses) and motor vehicles directly attributable to the provision and management of meter assets.

	<b>Segment assets at 31 December 2019 £'000</b>	<b>Segment liabilities at 31 December 2019 £'000</b>
Asset management impact	<b>905</b>	<b>893</b>

All other right-of-use assets relate to corporate assets that are not allocated to a segment.

The increase in EBITDA and EPS was not material for the year ended 31 December 2019.

*(ii) Practical expedients applied*

In applying IFRS 16 for the first time, the Group has used the following practical expedients permitted by the standard:

- the use of a single discount rate to a portfolio of leases with reasonably similar characteristics;
- reliance on previous assessments on whether leases are onerous;
- the accounting for operating leases with a remaining lease term of less than twelve months as at 1 January 2019 as short-term leases;
- the exclusion of initial direct costs for the measurement of the right-of-use asset at the date of initial application;
- and



- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

## **29 (b) The Group's leasing activities and how these are accounted for**

### *(i) Group as lessor*

Under IAS 17 it was concluded that the Group acts as a lessor in its arrangements to provide meter assets to energy suppliers. These leases were classified as operating leases as the Group did not transfer substantially all the risks and rewards of ownership of the meter assets. The related meter income was recognised on a straight line basis per the meter rental income policy.

As a result of the Company's assessment of contracts on implementation of IFRS 16, the arrangements the Group has in place to act as meter asset provider were reconsidered and it was determined that the contract does not constitute a lease of the meter asset to the energy supplier. SMS controls the meter as the Group retains legal title and obtains substantially all the economic benefit. The assets are recognised as property, plant and equipment when in use under contract with an energy supplier and related income for the service of providing a fitted meter is recognised in accordance with IFRS 15. Further information about the Group's accounting policy for revenue recognition is given in note 2 and for property, plant and equipment in note 10.

There is no impact on the recognition and measurement of income earned from the provision of meter assets as a result of this change.

### *(ii) Group as a lessee*

The Group leases various offices, warehouses and motor vehicles. Rental contracts are typically made for fixed periods of three to ten years but may have extension or early termination options. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants, but leased assets may not be used as security for borrowing purposes.

Until 1 January 2019, leases of property, plant and equipment were classified as either finance or operating leases and, as at 1 January 2019, all leases were classified as operating leases. Payments (net of any incentives received from the lessor) were charged to profit or loss on a straight line basis over the period of the lease.

From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight line basis.

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within the control of the lessee.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- variable lease payments that are based on an index or a rate;
- amounts expected to be payable by the lessee under residual value guarantees;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight line basis as an expense in profit or loss. Short-term leases are leases with a lease term of twelve months or less. Low-value

assets comprise IT equipment and small items of office furniture, where the value of the asset on inception is less than c.US\$5,000.

Payments for services are separated from the lease components of a contract and accounted for as an administrative expense.